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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. [redacted] 1

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

vs.

ENGINEERS PUBLIC SERVICE COMPANY, *et al.*

No. [redacted] 2

ENGINEERS PUBLIC SERVICE COMPANY, *et al.*,
Petitioners,

vs.

SECURITIES AND EXCHANGE COMMISSION

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia

BRIEF FOR ENGINEERS PUBLIC SERVICE COMPANY AND SUBSIDIARIES

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. 2

SECURITIES AND EXCHANGE COMMISSION,
Petitioner

vs.

ENGINEERS PUBLIC SERVICE COMPANY, *et al.*

No. 3

ENGINEERS PUBLIC SERVICE COMPANY, *et al.*,
Petitioners

vs.

SECURITIES AND EXCHANGE COMMISSION

On Writs of Certiorari to the United States Court of Appeals for the District of Columbia

BRIEF OF ENGINEERS PUBLIC SERVICE COMPANY AND SUBSIDIARIES

On applications by both the Securities and Exchange Commission (herein called the Commission) and Petitioners,[1] writs of certiorari were granted to review a judgment of the United States Court of Appeals for the District of Columbia. By agreement the two cases are being briefed and argued as one case and on a single record.

---

[1] The word "Petitioners" herein refers to the Petitioners in No. 3, i.e., Engineers Public Service Company and its subsidiaries.

Opinions Below

The opinion (R. 78-158) and order (R. 159-162) of the Commission dated September 16, 1942, and its opinion and order dated October 6, 1942 (R. 163-165), issued respectively as Holding Company Act Releases Nos. 3796 and 3835, are not officially reported. The opinion of the Court of Appeals (R. 1208-1235) is reported in 138 F. (2d) 936 (Ct. of App. D. C., 1943).

Jurisdiction

The judgment of the Court of Appeals was entered November 22, 1943 (R. 1236). The petitions for certiorari were filed on January 8, 1944 (No. 2), and January 27, 1944 (No. 3), and were granted June 5, 1944 (R. 1237). The jurisdiction of this Court rests upon Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, which is made applicable by Section 24(a) of the Public Utility Holding Company Act.

Statute Involved

The statute involved is the Public Utility Holding Company Act of 1935 (c. 687, 49 Stat. 803; 15 USCA §79), herein called the "Act", a sufficient number of which have been filed with this brief.

The Act provides for the registration of public-utility holding companies and for the substantive regulation of registered holding companies and their subsidiaries with respect to the issuance of securities, the sale and acquisition of assets, payment of dividends, etc. Section 11 of the Act provides for the integration and corporate simplification of registered holding companies.

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The section here involved is Section 11(b)(1), which, in essence, makes it the duty of the Commission to require each registered holding company to take such action as the Commission finds necessary to limit the operations of its holding-company system to a single "integrated public-utility system," as that term is defined in Section 2(a)(29), together with such additional integrated public-utility systems and such other businesses as meet the standards specified in Section 11(b)(1).

Questions Presented[2]

1. Is Section 11(b)(1) a proper exercise of the Congressional power to regulate commerce among the several States?

2. Does Section 11(b)(1) violate the due process clause of the Fifth Amendment?

3. Should the Commission have admitted evidence offered by Petitioners to establish that the provisions of Section 11(b)(1) are arbitrary and unreasonable, and therefore unconstitutional, in that they have no real or substantial relation to the purposes of the Act?

4. Was it permissible for the Commission to designate the single "integrated public-utility system" which Engineers may retain?

5. Does clause (B) of Section 11(b)(1) require that all integrated public-utility systems controlled by one holding company (including its "single" system) must be located in a single geographical area?

---

[2] Questions 1, 2, 3, 5 and 6 are raised in No. 3 and Questions 4 and 7 are raised in No. 2.

6. Does the phrase "substantial economies" in clause (A) of Section 11(b)(1) require something more than proof of substantial savings in operational expenses resulting from retention of control by the holding company?

7. Did the Commission properly order Engineers, under the "other business" clauses of Section 11(b)(1), to divest itself of all its interest in the water, ice, and gas appliance businesses owned by its subsidiary Gulf States and in the gas appliance business owned by its subsidiary Virginia?

Statement[3]

The Petitioner Engineers is engaged solely in the business of owning and holding shares of stock of public-utility and other corporations, financially assisting its subsidiaries, and carrying on activities incidental thereto. Engineers registered under the Act (reserving the constitutional rights of itself and subsidiaries),[4] and is thus a "registered holding company" (R. 51-52, 167-168, 1208-1210).

Petitioners Virginia, Gulf States, and El Paso (Texas) are operating subsidiaries of Engineers. Petitioner Epsco, Inc. is a mutual service company, duly qualified under Section 13 of the Act, the stock of which is owned by subsidiaries of Engineers (R. 51-53, 167-174, 1208-1210).

Disregarding companies and properties dealt with in prior orders of the Commission, not here in question (see R. 81, 157, 295-297), and also disregarding corporate

[3] In this brief Petitioners are referred to as follows: Engineers Public Service Company as "Engineers"; Virginia Electric and Power Company as "Virginia"; Gulf States Utilities Company as "Gulf States"; El Paso Electric Company, a Texas corporation, as "El Paso (Texas)"; and Engineers Public Service Company, Inc. (by change of name Epsco, Inc.) as "Epsco, Inc."

[4] See *Electric Bond Co.* v. *Comm'n*, 303 U. S. 419, 435 (1938).

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changes subsequent to the entry of the orders here in question, the following table shows each company now in the holding-company system of Engineers, the nature of each such company's business, and the geographical area in which it operates (R. 53, 83, 155, 167-168, 291, 1208-1210).[5]

---

[5] At the time of the divestment order of September 16, 1942 (R. 159-162) and at or shortly prior to the time of the issuance of the opinion of the court below (see R. 1209), Engineers owned, among other securities—

(a) substantially all of the capital stock of El Paso Electric Company (Delaware), which in turn owned all of the capital stock of

(1) El Paso (Texas), which then operated, in western Texas and New Mexico, street railway, bus and toll bridge businesses, in addition to its present electric utility, electric merchandising and jobbing businesses (R. 138-139, 167-168, 1209-1210), and

(2) El Paso and Juarez Traction Company, which operated a street railway and toll bridges in Mexico (R. 138-139, 167-168, 1209-1210);

(b) substantially all of the common stock, and a substantial proportion of the debenture stock Series A, of Savannah Electric and Power Company, which operated an electric utility business and various other businesses in Georgia;

(c) all of the capital stock of Baton Rouge Bus Company, Inc., which operated a bus business in Louisiana (R. 121-122, 167-168); and

(d) a minority stock interest in El Paso Natural Gas Company (R. 150).

Since the issuance of the opinion of the court below or shortly prior thereto—

(a) El Paso Electric Company (Delaware), having first sold the capital stock of El Paso and Juarez Traction Company, has been dissolved and liquidated,—so that, as shown in the table in the text below, Engineers now owns directly the capital stock of El Paso (Texas);

(b) El Paso (Texas) has sold its street railway, bus and toll bridge businesses; and

(c) Engineers has sold the capital stock of Savannah Electric and Power Company, the capital stock of Baton Rouge Bus Company, Inc., and its minority stock interest in El Paso Natural Gas Company.

At the time of the divestment order of September 16, 1942, and at the time of the issuance of the opinion of the court below, Virginia operated, in addition to the electric and gas utility and other businesses which it now operates, a street railway and bus system (R. 88) which it has recently sold.

Name of Company	Character of Business	States in Which Engaged in Business
Engineers	Holding Company	
El Paso (Texas)	Electric utility, electric appliance merchandising and jobbing	Western Texas and New Mexico
Virginia	Electric utility, gas utility, electric and gas appliance merchandising and jobbing, and ice	Virginia, West Virginia, and North Carolina
Gulf States	Electric utility, gas utility, electric and gas appliance merchandising and jobbing, ice, water, and steam	Eastern Texas and Louisiana
Epsco, Inc.	Mutual service company rendering services to companies in the Engineers' system	New York

By notice and order dated February 28, 1940, the Commission instituted the present proceedings, to determine what action was necessary in order that the holding-company system of Engineers should so limit its operations as to comply with Section 11(b)(1) of the Act (R. 156, 166-180).

Petitioners filed a motion to dismiss the proceeding (R. 156, 181-187), which was construed by the Commission as a request for a statement of its "tentative conclusions" (R. 156, 188-189). Petitioners also filed an answer challenging the validity of the Act and setting forth certain defenses (R. 156, 191-229). On March 11, 1941, the Commission issued its "tentative conclusions" (R. 230, 237).

Hearings were commenced before an Examiner on April 22, 1941, and closed on November 4, 1941 (R. 362-772). At

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these hearings Petitioners offered evidence, prepared in large part from theretofore unpublished material in the files of the Commission and the Federal Power Commission, to prove that the provisions of Section 11(b)(1) have no relation to the purposes of the Act (R. 248-251, 893-1140). This evidence was excluded by the Commission on the ground that it was without authority to pass upon the constitutionality of the Act (R. 163-164, 248-252, 289).

On September 16, 1942, the Commission entered an order (R. 159-162) which (disregarding properties which have since been disposed of) directed Engineers, within one year, to dispose of all its assets other than the securities of Virginia (i.e., all its interest in Gulf States, El Paso (Texas), and Epsco, Inc.), and to dispose of properties owned or operated by it through Virginia for the purpose of conducting any gas utility and gas appliance merchandising and jobbing businesses. Said order also provided, in effect (R. 149), in the event that Engineers should be permitted to select Gulf States, rather than Virginia, as its principal system, that Engineers should dispose of all properties owned or operated by it through Gulf States for the purpose of conducting any gas utility, gas appliance merchandising and jobbing, water and ice businesses (and, also, in such event, of all interest, direct or indirect, in Virginia, El Paso (Texas), and Epsco, Inc.).[6]

Said order of September 16, 1942, purported to give Engineers the right (R. 161), within 15 days, to petition for leave to retain as its single system, in lieu of Virginia, the electric utility system of Gulf States (which could be done only if leave so to do were granted by the Commission, the right to grant such leave being expressly reserved to the Commission).

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[6] See footnote 5, p. 5, *supra*.

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The effect of said order was to require Engineers to divest itself of all its properties other than Virginia and to cease carrying on all its other businesses except the electric appliance merchandising and jobbing business related to Virginia's electric utility business and a small ice business carried on by Virginia (R. 1208-1210). The assets of which Engineers was thus required to divest itself were carried on its books, as of December 31, 1940, at a value in excess of $30,000,000 (R. 253).

Thereafter, Petitioners filed a petition for rehearing and for leave to adduce additional evidence (R. 298-310). On October 6, 1942, the Commission denied said petition, but modified its order of September 16, 1942, so as to give Engineers an additional 15 days in which to petition for leave to retain Gulf States as its single system in lieu of Virginia (R. 163-165). No such petition was filed by Engineers.[7]

On November 22, 1943, upon a petition to review, the Court of Appeals of the District of Columbia entered its judgment reversing said orders and remanding the cause to the Commision for further proceedings (R. 1236). By its opinion said court—

(1) upheld the constitutionality of Section 11(b)(1) (R. 1232);

(2) sustained the Commission's refusal to admit evidence offered by Petitioners to show that Section 11(b)(1) is arbitrary and unreasonable (R. 1232-1234);

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[7] Previously, on July 23, 1941, and December 29, 1941, the Commission entered orders requiring Engineers to divest itself of its interests in certain companies not here involved (R. 81, 157, 295-297). No issues are here presented with respect to said orders.

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(3) adopted the Commission's so-called "one area" interpretation of clause (B) of Section 11(b)(1), under which all integrated public-utility systems controlled by one holding company, including its single system, are required to be located in one geographical area (R. 1213-1217), and under which, for example, Engineers was held to be entitled to continue to control *either* Virginia or Gulf States, but not *both* (R. 251-276);

(4) adopted,with one judge dissenting, the Commission's interpretation of the phrase "substantial economies" in clause (A) of Section 11(b)(1), under which, for example, Virginia was precluded from continuing to operate its gas system in connection with its electric system (R. 1217-1220);

(5) rejected the Commission's interpretation of the "other business" clauses of Section 11(b)(1), under which, for example, Engineers was required to divest itself of all interest in the water, ice, and gas appliance businesses of Gulf States and in the gas appliance business of Virginia (R. 1222-1229); and

(6) rejected the Commission's holding that it could select for Engineers the single integrated public-utility system which Engineers might retain (R. 1229-1232).

Specifications of Errors

The specifications of errors are set forth in the respective applications for writs of certiorari.

Summary of Argument

I. The Commerce Power

Section 11(b)(1) of the Act is not within the power of Congress to regulate commerce among the several States.

Nothing in Section 11(b)(1), by way of inclusion or exclusion, limits its application to interstate commerce or to matters affecting interstate commerce. Neither the terms used in Section 11(b)(1) nor the related definitions have any interstate commerce significance. (Point I, A.)

The relationship to interstate commerce of the securities and properties which may be ordered divested under Section 11(b)(1) is not self-evident and has not been established by decision of the Commission or any court, and no such relationship has been declared in the Act. (Point I, B.)

No proper assumption can be made that a registered holding company is engaged in, or that its security holdings affect, interstate commerce from the fact of its registration, or its failure to apply for exemption, under the Act. Holding companies are required to register without regard to their interstate activities; and the permitted exemption from the provisions of the Act turns on technical considerations having no bearing on interstate commerce. (Point I, C.)

No prior decision of this Court has extended the commerce power to the extent necessary to sustain the constitutionality of Section 11(b)(1). In sustaining the validity of Federal legislation under the commerce power, this Court has always found either a clear declaration by Congress that the matter regulated constituted or affected interstate commerce or there have been findings by a Commission or a court to such effect. No such declaration or finding is present here. If Section 11(b)(1) is held to be a proper exercise of the commerce power upon the basis of the legis-

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lative declarations in the Act, the distinction between interstate and intrastate commerce has disappeared entirely. (Point I, D.)

II. Due Process

Section 11(b)(1) retroactively takes lawfully acquired property of Petitioners for public use without just compensation. Regardless of the manner in which the Commission's orders are carried out, they (1) take away from Engineers the right to the continued use of the proceeds of over $39,000,000 of preferred stock and transfer such use to the preferred stockholders, (2) deprive Engineers of the valuable right of diversity resulting from the lawfully acquired ownership of at least three utility systems in three widely separated sections of the country, and (3) deprive Engineers of the valuable right of choosing the time for the disposition of its properties. (Point II, A.)

Evidence excluded by the Commission affirmatively establishes that the provisions of Section 11(b)(1) do not have any real or substantial relation to the purposes of the Act. Wholly apart from such evidence, however, Section 11(b)(1) violates the due process clause because it imposes severe and restrictive prohibitory devices which are wholly unnecessary for accomplishment of the legislative objectives in view of other applicable legislation, including other provisions of the Act. (Point II, B.)

III. Excluded Evidence

The Commission excluded evidence (covering over 95% of the nation's entire utility industry during 1939 and 1940) offered by Petitioners to show, as a fact, that the provisions of Section 11(b)(1) have no real or substantial

relation to the purposes of the Act. (Point III, A.) The relevancy and admissibility of such evidence is established by many decisions of this Court. (Point III, B.)

The Commission has authority, and is under a duty, to deal with constitutional issues; but whether or not this be so, it should have received the proffered evidence and made findings with respect thereto since this is the only feasible way in which Petitioners may fully and completely exercise their undoubted right to challenge the validity of the Act. This conclusion is required by Section 24 of the Act, by the authorities, by elemental considerations of fairness, and by practical considerations affecting judicial review of administrative action. (Point III, B.)

IV. Engineers' Choice of its Single System

Having first found that Virginia and Gulf States each constituted an "integrated public-utility system", the Commission directed Engineers to divest itself of all properties except Virginia, unless within a 15-day period (subsequently renewed for a further 15-day period) Engineers should petition for leave to retain Gulf States instead of Virginia, and the Commission, after consideration of the "merits", should grant such petition. The Commission thus itself selected, or reserved the right to select, the single system which Engineers may retain as between two admittedly eligible systems. In this respect, as the court below held, the Commission usurped a right which belongs to Engineers, since (a) the Act does not purport to confer any such authority upon the Commission, and (b) if it did, it would be invalid as an unlawful delegation of legislative power, there being no legislative standards to govern the Commission in exercising any such authority. (Point IV, A.)

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If Section 11(b)(1) were valid as to Petitioners and if the Commission's interpretation of clause (B) were correct, the only form of order which the Commission might lawfully enter in the case at bar is one which orders divestment of *either* Virginia or Gulf States within the prescribed period for divestment. (Point IV, B.)

V. The "one-area" interpretation attributed to clause (B) of Section 11(b)(1)

Under the Commission's "one-area" interpretation of clause (B), a holding company cannot retain properties in more than one geographical area. This interpretation is plainly wrong. The language of clause (B) is clear, and requires only that all of the "additional systems" be "located in one State, or in adjoining States, or in a contiguous foreign country". This language unmistakably permits retention of properties in at least two geographical areas. The Commission and the court below concede that the "one-area" interpretation of clause (B) results in distortion of the language by requiring the addition, after the word "State", of the words "in which the single integrated public-utility system is located". (Point V, A.)

There is nothing in the legislative history of Section 11(b)(1) which justifies this distortion of the plain language of the Act. Although some of the statements in the Committee Reports are ambiguous (and as such cannot be the basis for altering the language used by Congress), an overall view of the legislative history definitely supports the "two-area" interpretation, i.e., sustains the clear meaning of the language used. (Point V, C and D.)

The clear meaning of clause (B) may not be distorted by alleged practical considerations, especially in view of the fact that the legislation in question was the result of a compromise of sharply conflicting views, and the further

fact that the alleged "absurdities" resulting from the "two-area" interpretation are more than counter-balanced by "absurdities" resulting from the "one-area" interpretation. (Point V, D.)

VI. Interpretation of the Phrase "Substantial Economies" in Clause (A) of Section 11(b)(1)

The Commission and a majority of the court below interpreted clause (A)—which permits a holding company to retain one or more additional systems, which meet the (B) and (C) standards, if such systems cannot be operated independently "without the loss of substantial economies" —as requiring convincing evidence "of a loss of economies which would seriously impair the effective operations of the systems involved". On the basis of such interpretation, the Commission required Virginia to divest itself of its gas system, notwithstanding the conceded fact that separation of the gas system from Virginia would result in overall increases in operational expenses of $91,730 annually (the loss of savings incident to the gas system alone corresponding to a decrease of 13.3% in the gross gas income for 1940 and 29.8% in the gas income available for dividends). On the same basis, and on the assumption that Gulf States may ultimately become Engineers' single system, the Commission found that Gulf States could not continue to own its Baton Rouge gas system, notwithstanding the conceded fact that separation of said system from Gulf States would result in an overall increase of operational expenses of $77,452 annually.

The Commission's interpretation of clause (A) reflects (1) a reluctance to permit any holding company to operate both a gas and electric system in the same community, notwithstanding express Congressional rejection of any such objective, and (2) the wholly unproven and conjectural

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assumption of economic benefits from competition between the severed systems.

Petitioners contend, as held by the dissenting judge, that the phrase "substantial economies" requires only a showing of substantial savings in operational expenses resulting from retention of control by the holding company. A primary objective of the Act is protection of investors and consumers. This objective is plainly served by Virginia's continued operation of both its electric and gas systems. The Commission's conclusion that the admitted substantial economies resulting from joint control will be offset, in the event of a severance, by alleged beneficial effects of independent ownership is wholly without foundation in the evidence.

VII. Interpretation of the "Other Business" Clauses of Section 11(b)(1)

Although Section 11(b)(1) provides that a holding company must be allowed to retain "such other businesses as are reasonably incidental, or economically necessary or appropriate" to the operations of its public-utility system, and that, in this connection, the Commission must permit the holding company to retain any business which the Commission shall find "necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems", the Commission held that Engineers could not retain its interest in any "other business" unless there was a *functional relationship* between such other business and the retainable system; and on the basis of such interpretation, the Commission required Engineers to divest itself of all interest in Virginia's gas appliance businesses and in Gulf States' water, ice, and gas appliance businesses.

As the court below held, there is no basis in the language of the "other business" clauses or elsewhere for requiring any such functional relationship. This conclusion is supported by the legislative history, which shows that the statutory provisions in question were designed so as "not to cause interference with State policy which allows or fosters the carrying on of water-works, traction business, bus systems, etc., by electric and gas utilities."

ARGUMENT

I

Section 11(b)(1) is not within the power of the Congress to regulate commerce among the several States

In upholding the validity of Section 11(b)(1) the court below has extended the commerce power far beyond limits indicated in the decisions of this Court. If the power of Congress to require divestment of valuable, long-established, and legally-acquired property rights is sustained, as a regulation of interstate commerce, upon the basis of alleged legislative findings such as are contained in the Act, all constitutional limits upon the exercise of Federal power over purely intrastate activities will, for all practical purposes, have vanished.

A. Section 11(b)(1) Authorizes the Commission to Order Registered Holding Companies to Divest Themselves of Properties Without Regard to Any Relationship Thereof to Interstate Commerce

Section 11(b)(1) does not on its face even purport to be a regulation of interstate commerce or of matters affect-

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ing such commerce. It merely prescribes conditions which must be met if the ownership or control of certain properties is to be retained; and those conditions do not in any way relate such ownership or control to interstate commerce.

It provides as follows:

"Sec. 11. (b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system: *Provided, however,* That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

> The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems."

This section authorizes the Commission, by order, to limit the operations of a holding company system to a single "integrated public-utility system" (defined in Section 2(a)(29) without relation to interstate commerce) and to such "other" businesses, i.e., businesses other than gas and utility businesses, "as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system" (again without relation to interstate commerce), with certain exceptions as to additional integrated systems which may be retained if the requirements of clauses (A), (B) and (C)—commonly known as the ABC standards—are met. These ABC standards likewise have no relation to interstate commerce. A is an economic test; B is a geographical test which expressly includes a system even though it be located in a single State; and C is a size test dealing with the advantages of localized management, efficient operation and effectiveness of regulation.

On the face of Section 11(b)(1), therefore, the criteria which determine whether properties may be retained are wholly unrelated to interstate commerce. Going beyond the face of Section 11(b)(1), it appears that none of the terms used therein is elsewhere defined in a manner which requires an interstate commerce relationship.

The term "integrated public-utility system", either gas or electric, is defined in Section 2(a)(29) as a system "phy-

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sically interconnected or capable of physical interconnection" as to electricity or "coordinated" as to gas, confined in its operations "to a single area or region, *in one or more States*, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation," with a provision as to gas that gas utility companies deriving natural gas from a common source may be deemed to be included in a single area or region. This definition clearly does not constitute an interstate commerce test. An electric system operating in a single region in several States and physically interconnected, and thus presumably engaged in interstate commerce, would fall within the definition and might, therefore, be retainable. If, however, an electric system were not physically interconnected or capable of interconnection it would not fall within the definition and, therefore, would not be retainable, even if the units were all located in a single State and no interstate commerce were involved or affected.

The term "holding company" is defined in Section 2(a)(7), without any reference to interstate commerce, as "any company which directly or indirectly owns, controls, or holds with power to vote, 10 per centum or more of the outstanding voting securities of a public-utility company", or as any person determined by the Commission to have such a controlling influence over a public-utility or holding company as to make it necessary or appropriate "in the public interest or for the protection of investors or consumers" that such person be subject to the obligations, duties and liabilities of holding companies. There is also a provision in Section 2(a)(7) which authorizes the Commission, without any reference to interstate commerce, to exclude from the holding company definition, a company

which does not control a public-utility company, is not an intermediary company through which such control is exercised and does not exercise such a controlling influence "as to make it necessary or appropriate in the public interest or for the protection of investors or consumers" that the applicant be subject to the obligations imposed upon holding companies.

The term "subsidiary company," defined in Section 2(a)(8), is the counterpart of the definition of holding company with a similar exclusion provision, and here, again, there is no reference to interstate commerce.

The term "public-utility company" is defined by Section 2(a)(5) as either an "electric utility company or a gas utility company". Those terms are defined in Sections 2(a)(3) and (4) without reference to interstate commerce. Both latter sections have clauses, without interstate commerce significance, which authorize the Commission to exclude companies from the definitions. The gas utility exclusion clause has no reference to the place or places of operation or to effect on interstate commerce. In the electric utility exclusion clause there is, in Section 2(a)(3)(B), a reference to operation in a "single State"; but this is without interstate significance since in order to grant the benefit of the exclusion the Commission must, in addition to finding that the company operates only in a single State, also find that substantially all its securities are owned by another company to which such operating company sells or furnishes electric energy which it generates, and such other company must use and not resell such electric energy, must be primarily engaged in manufacturing something other than gas or electricity and must not be controlled by another company, and in addition the Commission must find that, by reason of the small amount of electric energy sold

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or furnished by such operating company to other persons, it is not necessary in the public interest or for the protection of investors or consumers that it be considered an electric utility company. Hence, even if an electric utility be operating in a single State, it is not entitled to exclusion unless a number of conditions having no relation to interstate commerce are also met.

Therefore, neither in Section 11(b)(1) nor in the maze of involved definitions do we find anything which can possibly be deemed, by way of inclusion or exclusion, to have any interstate significance whatsoever.

We will discuss later herein the significance of the word "registered" as applied to holding companies.

B. The Relationship to Interstate Commerce of the Ownership of Properties Which May be Divested Under Section 11(b)(1) is Not Self-Evident and, in the Case at Bar, Has Not Been Established

In *Santa Cruz Co.* v. *Labor Board*, 303 U. S. 453 (1938), this Court said (p. 466):

> "* * * It is also clear that where federal control is sought to be exercised over activities which separately considered are intrastate, *it must appear that there is a close and substantial relation to interstate commerce in order to justify the federal intervention for its protection.* However difficult in application, this principle is essential to the maintenance of our constitutional system. The subject of federal power is still 'commerce', and not all commerce but commerce with foreign nations and among the several States. The expansion of enterprise has vastly increased the interests of interstate commerce but the constitutional differentiation still obtains. (italics supplied)[8]

[8] All italics in quotations herein are supplied unless otherwise noted.

It being axiomatic that intrastate activities are not subject to Federal control unless there is "a close and substantial relation to interstate commerce", the question in each case is whether, and how, such relationship is established.

In some cases the relationship is so self-evident that it may properly be assumed, as where the very subject matter of a Federal statute is itself an instrumentality of interstate commerce. Such a case is *United States* v. *Ferger*, 250 U. S. 199 (1919), which involved a statute dealing with the issuance of spurious bills of lading in interstate commerce. There the subject matter of the legislation, in its very nature, constituted or affected interstate commerce.

The Act here involved is not legislation of that character. The "activity" (i. e., the ownership and control of securities) on which Section 11(b)(1) operates may, and in the case at bar does, include matters of a purely local or intrastate character without regard to whether or not they affect interstate commerce in any way.

For example: Among the properties of which Engineers is required to divest itself are water properties owned by its subsidiary Gulf States. These properties are located in three communities in Louisiana and four communities in Texas. The several properties are not physically interconnected and the water pipes and facilities do not cross any State line. The largest of these properties, located in Lake Charles, Louisiana, represents 57 of the Company's 119 miles of water main and an investment of $830,000 (R. 651). The Commission's order of September 16, 1942, requires Engineers to dispose of its entire interest in Gulf States, including, of course, the water properties; and if Gulf States is retained as Engineers' principal system, the latter must still divest itself of said water properties (R. 154).

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If there is any business which is local in operation and effect, it is the Lake Charles water business of Gulf States. It is located in a single community. Water is pumped out of the ground in Lake Charles, treated at a plant located in Lake Charles, and distributed to inhabitants through pipes laid in the streets of Lake Charles. This situation, as well as other similar situations in the case at bar, is the antithesis of the *Ferger* case. There the legislative subject matter was plainly interstate. Here the subject matter is as plainly intrastate.

The same can be said of the gas business owned by Gulf States in Baton Rouge, Louisiana, and the gas business owned by Virginia in Norfolk, Virginia. Both of those also are ordered to be divested by the order of September 16, 1942 (R. 154). These properties are not small and unimportant; they represent an investment of many millions of dollars.

Thus, the ownerships which are the subject of this Act may or may not be or affect interstate commerce, and their relationship to such commerce is not self-evident. In such cases, such relationship cannot properly be assumed but "must appear" in some other manner; and in *United States* v. *Darby*, 312 U. S. 100 (1941), the Court pointed out the three ways in which this could be done. The Court there said (pp. 120-121):

> "In such legislation Congress has sometimes left it to the courts to determine whether the intrastate activities have the prohibited effect on the commerce, as in the Sherman Act. It has sometimes left it to an administrative board or agency to determine whether the activities sought to be regulated or prohibited have such effect, as in the case of the Interstate Commerce Act, and the National Labor Relations Act, or whether they come within the statutory

> definition of the prohibited Act, as in the Federal Trade Commission Act. And sometimes Congress itself has said that a particular activity affects the commerce, as it did in the present Act [the Fair Labor Standards Act of 1938], the Safety Appliance Act and the Railway Labor Act. In passing on the validity of legislation of the class last mentioned, the only function of courts is to determine whether the particular activity regulated or prohibited is within the reach of the federal power * * *."

It is conceded by the Commission that neither of the first two ways above mentioned has any application here. The only hearing on the facts provided by the Act is one before the Commission. The Act does not require or contemplate that the Commission shall make any finding as to whether interstate commerce is affected; and the Commission made no such finding in the instant case. The lengthy findings and opinion of the Commission may be searched in vain for any mention of the term "interstate commerce". The Commission's jurisdiction is so restricted, as it admitted in its brief below, that any findings by it as to interstate commerce would have been "improper".

Nor does the Act contemplate that any court shall make findings with respect to interstate commerce; and no such findings were made in this case by the court below.

The only question remaining is whether Congress itself has made the requisite findings. Apparently the court below thought that the declarations in Section 1 of the Act were adequate for this purpose.[9] An analysis of those

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[9] The court below (R. 1232) apparently sustained the constitutionality of Section 11(b)(1) on the basis of its prior decision in *Central & S. West Utilities Co.* v. *Securities & E. Com'n*, 136 F. (2d) 273, 275 (1943), which, in turn, was predicated upon *North American Co.* v. *Securities and Exchange Com'n*, 133 F. (2d) 148 (C. C. A. 2d, 1943), No. 1, October Term, 1945, and *Commonwealth & South. Corp.* v. *Securities and Exch. Com'n*, 134 F. (2d) 747

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declarations, however, shows a complete absence of any legislative finding that the intrastate activities here sought to be subjected to Federal control, i. e., the ownership and control by Petitioner Engineers of securities of subsidiary corporations, constitutes or affects interstate commerce.

In parallel columns below, we place the declarations of Section 1 of the Act and the Congressional action which might reasonably be supported thereby:

"Section 1.(a) Public-utility holding companies and their subsidiary companies are affected with a national public interest in that, among other things,	
"(1) their securities are widely marketed and distributed by means of the mails and instrumentalities of interstate commerce and are sold to a large number of investors in different States;	This declaration may reasonably support the regulation of such security issues pursuant to Sections 6 and 7 of the Act; but the mere fact that persons use the mails does not in and of itself give Congress general

(C. C. A. 3d, 1943). In the *North American* case the Circuit Court of Appeals for the Second Circuit apparently was of the opinion (see 133 F. (2d) at p. 153) that the legislative findings in the statute adequately established the effect upon interstate commerce, and the Circuit Court of Appeals for the Third Circuit in the *Commonwealth & Southern Corporation* case, which involved the constitutionality of Section 11(b)(2), specifically found (see 134 F. (2d) at p. 753) that Congress itself had incorporated in the Act its conclusion "that unduly complicated corporate structures of holding companies affected interstate commerce adversely". It is respectfully submitted, as shown in the text, that these conclusions are wholly ill-founded. See also, *American Power & L. Co.* v. *Securities and Ex. Com'n* and *Electric Power & Light Corporation* v. *Securities & Exch. Commission*, 141 F. (2d) 606 (C. C. A. 1st, 1944), Nos. 6 and 7, October Term, 1945, upholding the constitutionality of Section 11(b)(2)—not involved in this case—substantially on the authority of the cases mentioned above in this footnote.

control over the intrastate activities of such persons.

"(2) their service, sales, construction, and other contracts and arrangements are *often* made and performed by means of the mails and instrumentalities of interstate commerce;

This declaration that the mails and instrumentalities are "often" used for the specified purposes shows that they are not always so used; this declaration might support the regulation of such services as provided in Section 13 of the Act in cases where the mails and such instrumentalities were used, but would not support such regulation in cases where they were not. Certainly the mere use of the mails would not authorize Federal control of *all* local and intrastate activities of holding companies and their subsidiaries.

"(3) their subsidiary public-utility companies *often* sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce;

No attempt is made in the Act to regulate the interstate transmission of gas and electric energy (except as it may result incidentally through a Section 11(b)(1) divestment), but it is clear that the statement that subsidiaries "often" use instrumentalities for such purpose could not support the regulation of a subsidiary which does not do so. Moreover, the fact that the subsidiaries of a holding company trans-

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port electricity and gas by means of interstate commerce does not authorize Federal control over the ownership of the securities of such subsidiaries.

"(4) their practices in respect of and control over subsidiary companies *often* materially affect the interstate commerce in which those companies engage;

This language, upon which the Commission strongly relies, falls far short of justifying the extraordinary divestments of property rights of the character here involved. In the first place, the word "often" is again used. Such a declaration cannot support the exercise of Federal power in *all* cases. There has been no finding that the practices of Engineers over its subsidiary companies materially affect any interstate commerce. And in no event could such legislative declaration justify Federal control over the subsidiaries of holding companies to the extent that such subsidiaries do not engage in interstate commerce.

"(5) their activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies."

This declaration has no Federal significance; from the absence or ineffectiveness of State power, no Federal power can arise.

Section 1(b) of the Act declares that "the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or *may be* adversely affected—(1) *when*" certain conditions exist. Then follows a statement of the "evils" which it is said were disclosed by the Congressional investigations.

None of these conditions or "evils" relate to interstate commerce in any way.

"Section 1(c) When abuses of the character above enumerated become persistent and widespread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly

The declaration contained in Section 1(c) to the effect that it is the policy of the Act "to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce" is tantamount to a declaration by the Congress that it is not the policy of the Act to meet the problems or eliminate the evils connected with holding companies which are not engaged in interstate commerce or in activities which directly affect or bur-

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affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title."

den interstate commerce, yet no such limitation appears in Section 11(b)(1); and the Commission has made no finding which enables this Court to determine whether the divestment order in the case at bar is in accord with the legislative policy as so declared.

The fact that a holding company sells securities in interstate commerce [Section 1(a)(1)] may authorize Federal regulation of such sales; the fact that the service contracts of a holding company and its subsidiaries are made and performed through the instrumentalities of interstate commerce [Sec. 1(a)(2)] may authorize Federal regulation of such service contracts; and the fact that subsidiaries of holding companies transport electricity and gas in interstate commerce [Section 1(a)(3)], may authorize Federal regulation of such transportation. But none of these declarations, or all of them put together, authorize Congress to order the divestment of valuable, lawfully acquired properties, wholly without regard to their relation to interstate commerce, as is done by Section 11(b)(1).

The broadest Congressional declaration, and the only one which could even be made the basis of a claim in support of Section 11(b)(1), is that contained in Section 1(a)(4) to the effect that "their (*i.e.*, holding companies') practices in respect of and control over subsidiary com-

panies *often* materially affect the interstate commerce in which those companies engage."

That this statement is not sufficient for the purpose is apparent. Instead of being a statement that such practices *always* affect interstate commerce, it is a clear admission that they do not always do so. The statement is certainly insufficient to justify regulation in all cases. It should have been supplemented by provisions for findings that, *in the particular case involved, the alleged effect on interstate commerce is present.* The fact is, however, that neither Section 11(b)(1) nor any other provision in the Act contains any procedure for making any such determination and admittedly no such determination has been made in the case at bar.

If the declaration in Section 1(a)(4) is held sufficient to support divestment orders without findings that the holding of the property proposed to be divested affects interstate commerce, the door is opened wide for the Federal regulation of purely intrastate matters. The same Congressional statement could as truthfully be made in respect of *all* important industrial corporations in the country which carry on their operations through subsidiaries; and such is the common form. In the application of a Federal power, there is nothing peculiar to public utilities.

Petitioners are entirely warranted in emphasizing the word "often" as used in Section 1(a)(4) since the legislative history shows that the use of this word was deliberate. The legislation was initiated by substantially identical bills on February 6, 1935 (S. 1725 and H. R. 5423, 74th Cong., 1st Sess.; S. Rept. No. 621, 74th Cong., 1st Sess., p. 1). Section 1(a)(4) of H. R. 5423—with which Section 2(a)(4) of S. 1725 is substantially identical—made an unqualified finding as follows (Hearings before House Committee on

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Interstate and Foreign Commerce on H. R. 5423, 74th Cong., 1st Sess., Part 1, p. 1):

> "Section 1. (a) Public utility holding companies and their subsidiary companies are affected with a national public interest in that, among other things,
>
> . . .
>
> 4. their practices and control over subsidiary companies materially affect the interstate commerce in which those companies engage".

Thereafter these bills were referred to committees and, after several months of hearings and investigations, the Senate passed a bill (S. 2796, 74th Cong., 1st Sess.) on June 11, 1935 (79 Cong. Rec. 9065), which, with amendments, was passed by the House on July 2, 1935 (79 Cong. Rec. 10639-10640). This bill then went to conference and was enacted on August 24, 1935, in the form reported by the Conference Committee. (79 Cong. Rec. 14626-14627, 14469-14473).

Section 1(a)(4) in S. 2796 as originally introduced was the same as Section (1)(a)(4) in H. R. 5423 (see S. Rept. No. 621, 74th Cong., 1st Sess., p. 21), but when passed by the Senate and the House on June 11 and July 2, 1935, respectively, it was in the form *as it now appears in the Act.* It appears, therefore, that Congress inserted the word "often" after protracted consideration, and the conclusion necessarily follows that the unqualified language of the bills as originally introduced was changed to the form in which the Act was finally enacted *because of the conviction that the unqualified statement contained in the original bills would not express the truth.*

As above shown, if Section 11(b)(1) is constitutional, Engineers must divest itself of its interest in properties, such as the Lake Charles water business, the Virginia gas business, and the Gulf States gas business, which, so far

as the record shows, are purely local and do not have any relation to interstate commerce. There is no declaration in the Act which conceivably authorizes divestment of such properties as a regulation of interstate commerce; and even if Congress had specifically declared that businesses such as the Lake Charles water business substantially affect interstate commerce, this Court would clearly have to rule, following its statement in *United States* v. *Darby* (see 312 U. S. at pp. 120, 121), that the "particular activity . . . prohibited" was not "within the reach of the federal power."

As shown above, there is a total absence of any findings by the Commission that the properties here ordered to be divested affect interstate commerce. But even if such findings had been made, there would be no foundation for the exercise of the power asserted. To sustain such power, the Act would have to go at least as far as to declare that the ownership and control of these properties constituted or substantially affected interstate commerce or to provide for findings to that effect by the Commission or a court. The Act does neither.

C. Registration Under the Act and Failure to Apply for Exemption Cannot be Made the Basis of any Assumption that a Registered Holding Company is Engaged in, or That Its Holdings Affect, Interstate Commerce

Section 11(b)(1) applies only to "registered" holding companies and subsidiary companies thereof. We have already shown (Point I, A) that in the definitions of the terms "holding company", "subsidiary company", "integrated public-utility system", and related definitions there are no provisions which limit the operation of Section 11(b)(1) to holding companies or subsidiaries which are engaged in or affect interstate commerce. It remains to examine the significance of the word "registered."

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In its brief in the court below, the Commission argued that since Engineers has registered under Sections 4 and 5 of the Act and has not applied for exemption under Sections 3(a)(1) and 3(a)(2), "The Commission was entitled to assume, without express findings, that Engineers was a holding company interstate in nature and engaged in interstate commerce". Essentially the same argument appears in the Commission's brief (dated April, 1943) in this Court in the *North American Company* case, No. 1, present term (No. 6, October Term, 1943), in which it is contended (pp. 24-36) that registered holding companies are "interstate enterprises" whose "activities are carried on in interstate commerce", and that "Congress has determined that the activities of registered holding companies affect interstate commerce". This argument, which seems to have been accepted by the Circuit Court of Appeals in the *North American Company* case (see 133 F. (2d) at p. 153), is, we submit, patently fallacious. An examination of Sections 3(a), 4 and 5 establishes, beyond contradiction, that the mere facts of registration and failure to apply for exemption do not in and of themselves bring all registered holding companies within the scope of the commerce power.

Under Section 4(a) it is unlawful for a holding company, unless it registers under Section 5, to do any one of the things described in paragraphs (1) to (6). Of these, (1) and (5) deal with interstate activities. Paragraphs (2), (3) and (4) cover the "use of the mails or any means or instrumentality of interstate commerce" for: (2) the entering into of any service, sales or construction contract, (3) making any public offering of any security, and (4) acquiring or negotiating for the acquisition of any security or utility assets of a subsidiary. And paragraph (6) forbids a holding company "to own, control, or hold with

power to vote, any security of any subsidiary company thereof that does any of the acts enumerated in paragraphs (1) to (5) . . . .".

Section 4(b) requires registration by "Every holding company which has outstanding any security any of which, by use of the mails or any means or instrumentality of interstate commerce, has been distributed or made the subject of a public offering subsequent to January 1, 1925, and any of which security is owned or held on October 1, 1935 . . . by persons not resident in the State in which such holding company is organized . . . ."

Bearing in mind that the Act does not require a holding company registering under it to state the reasons for such registration, and that neither the Commission nor the court below made any findings as to why Engineers registered, any assumption to be drawn from the mere fact of registration must fairly include *any* reason which may have led to such registration. Accordingly, in light of the provisions of Section 4 above quoted, it may only be assumed from the fact that Engineers registered under the Act:

> (1) that one of its subsidiary companies (which may have been operating wholly intrastate) used the mails (possibly for a communication wholly intrastate) to make a service, sales or construction contract, or to sell a security or acquire a utility asset; or
>
> (2) that at some time, perhaps as long as ten years and seven months prior to the passage of the Act, someone—with whom Engineers need not have had any relationship—distributed Engineers' securities in interstate commerce, some of which securities were held on October 1, 1935, by persons not residents of the State of Delaware, under the law of which Engineers is organized.

Since registration may thus be required for reasons which have no relation whatever to interstate commerce, the mere

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fact that a holding company registers under the Act obviously does not establish that the activities of such company constitute or affect interstate commerce.

The "exemption" provisions are as follows:

> "Sec. 3. (a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any holding company, and every subsidiary company thereof as such, from any provision or provisions of this title, *unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers,* if—
>
> (1) such holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character *and carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized;*
>
> (2) such holding company is predominantly a public-utility company whose operations as such do not extend beyond the State in which it is organized and States contiguous thereto;"

Neither the Commission nor the court below made any finding as to why Engineers did not apply for exemption. It may therefore properly be assumed, from the provisions of Section 3(a), that Engineers failed to apply for exemption for reasons having no relation to interstate commerce, as, for example:

(1) because, as is the fact, it and all of its subsidiaries are not incorporated in "a single State"; or

(2) because, as is the fact, it is not predominantly a public-utility company.

Being a Delaware corporation, Engineers is not eligible for exemption because it has subsidiaries which are incorporated in other States; and it would still be ineligible even if all such subsidiaries carried on purely intrastate activities. Being a holding company and not "predominantly a public-utility," Engineers is not eligible for exemption; and this would be so even if all its holdings were in companies engaged solely in intrastate activities in a single State. Moreover, apart from these problems, Engineers still would not be eligible for exemption if the Commission should find such exemption "detrimental to the public interest or the interest of investors or consumers". Plainly, "exemption" under the Act has no interstate commerce significance.

Apparently recognizing the difficulty of attributing any interstate commerce significance to Section 3(a), the court in *American Power & L. Co.* v. *Securities and Ex. Com'n*, 141 F. (2d) 606, 621 (C. C. A. 1st, 1944), No. 6, present Term, in upholding the constitutionality of Section 11(b)(2) —not involved in this case—stated that the Commission had interpreted its "power of exemption" in light of the policy of the Act, and had—

> ". . . ruled that an exemption otherwise allowable should not be denied under the 'unless and except' clause of §3(a), unless the exemption would be detrimental to the interests of the public or of investors or consumers 'by reason of any activities of the applicant or of any such subsidiary company in interstate commerce, or directly affecting or burdening interstate commerce,' "

citing *Long Island Lighting Company*, 1 S. E. C. 345, 346 (1936).

We question, however, whether it is permissible for the Commission and a court thus to rewrite Section 3(a),

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especially on the basis of an "interpretation" of the statute which finds no support whatever in either the language or legislative history of the statute (see S. Rept. No. 621, 74th Cong., 1st Sess., pp. 6, 24-25; H. Rept. No. 1318, 74th Cong., 1st Sess., pp. 5, 10-11) and which the Commission is free to change at any time. By the same technique the Commission could readily solve all constitutional doubts as to Section 11(b)(1) by "interpreting" that section to apply only to holdings of securities which are in, or which affect, interstate commerce! But quite apart from such considerations, and the further fact that the *Long Island Lighting Company* case involved Section 3(c) of the Act which provides for the revocation and not the granting of exemptions, the Commission would still, under certain circumstances, have to deny exemption to a company whose activities are purely intrastate, unless, indeed, it disregards or rewrites the balance of Section 3(a). The "unless and except" clause in Section 3(a), which the Commission is said to have "interpreted" in relation to the effect upon interstate commerce in the *Long Island Lighting Company* case, calls merely for a preliminary finding, and exemption is not to be granted unless *other provisions, having no relation to interstate commerce, are also met.* For example, even if the Commission made the requisite preliminary finding under the Commission's alleged "interpretation" of the "unless and except" clause in Section 3(a), it would still have to refuse exemption to a holding company carrying on its business substantially in a single State unless it and all its public-utility subsidiaries were also organized in such State. Obviously, this is a factor without any interstate commerce significance whatever. In this connection, it should be noted that in the *Long Island Lighting Company* case the Commission found that the Company there involved and every public-utility subsidiary thereof were

all organized under the laws of New York (see 1 S. E. C. at p. 345).

This point as applied to the present case is not merely theoretical. Even under the Commission's asserted "interpretation" of the "unless and except" clause in Section 3(a) the Commission could not grant exemption to Engineers because the Commission could not find, as required by sub-section (1) of Section 3(a), that that company and all its subsidiaries from whom it derives any material part of its income "carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized * * *". It follows that if Engineers had applied for exemption under Section 3(a) the Commission would have been compelled to deny such exemption on grounds having no relation to interstate commerce.

Since both registration and failure to apply for exemption may, therefore, be predicated entirely on considerations having nothing whatever to do with whether the holding company is or is not engaged in, or does or does not affect, interstate commerce, the Commission was not entitled to assume, merely from the fact of registration and the failure to apply for exemption, that Engineers "was a holding company interstate in nature and engaged in interstate commerce". *A fortiori*, it was not entitled to assume, because of such registration and failure to apply for exemption, that interstate commerce is substantially affected by the ownership of the securities of which Engineers was ordered to divest itself.

Further authority for this conclusion is found in *Electric Bond Co.* v. *Comm'n, supra,* in which this Court upheld the constitutionality of Sections 4 and 5 of the Act, the registration provisions, but expressly reserved decision as

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to the validity of the other provisions of the Act. If registration and failure to apply for exemption were in and of themselves sufficient to sustain the constitutionality of Section 11(b)(1), it would have been quite unnecessary for this Court in that case to have dealt at length with the central issue therein, namely, whether Sections 4 and 5 were separable from the rest of the Act. In this connection, the Court specifically stated (see 303 U. S. p. 435) that—

> "It is idle to contend that registration pursuant to the decree will subject the defendants to the Act as an integrated whole . . ."

D. In Upholding the Constitutionality of Section 11(b)(1) the Court Below Has Extended the Commerce Power Far Beyond the Limits Established by the Decisions of this Court

The applicable rule as laid down by the decisions of this Court may be stated as follows: While Congress has "plenary" power to make effective any rule which it prescribes for interstate commerce by regulating or prohibiting intrastate activities which otherwise would interfere substantially with the operation of such rule, in order to bring an activity (which is not self-evidently interstate commerce) within the commerce power, Congress must either itself declare unmistakably that such activity substantially affects interstate commerce or it must provide for the determination of such relationship by a court or administrative agency. This basic rule applies no matter how difficult may be its application. *Santa Cruz Co.* v. *Labor Board,* 303 U. S. 453, 466 (1938), *supra; United States* v. *Darby,* 312 U. S. 100, 121 (1941), *supra; U. S.* v. *Wrightwood Dairy Co.,* 315 U. S. 110, 120 (1942); *Labor*

Board v. *Jones & Laughlin*, 301 U. S. 1, at 32, 38 (1937); *Wickard* v. *Filburn*, 317 U. S. 111, 124-125 (1942).

In the case at bar, the relation of the activity regulated (i. e., the ownership by Engineers of securities of its subsidiaries) to interstate commerce is not self-evident, and there has been no finding by the Commission or any court or by the Congress that such "activity" substantially affects interstate commerce. Upon such state of facts it is clear, upon an analysis of recent decisions of this Court, that the challenged divestment order is wholly without constitutional basis.

Sunshine Coal Co. v. *Adkins*, 310 U. S. 381 (1940), involved the constitutionality of the Bituminous Coal Act of 1937, which established a code designed "to regulate interstate commerce in bituminous coal". In this statute Congress expressly declared (50 Stat. 72) that "Regulation of the sale and distribution in interstate commerce of bituminous coal is imperative for the protection of such commerce", and that "there exist practices and methods of distribution and marketing of such coal that waste the coal resources of the Nation . . . and obstruct interstate commerce in bituminous coal, with the result that regulation of the prices thereof and of unfair methods of competition therein is necessary to promote interstate commerce in bituminous coal and to remove burdens and obstructions therefrom." In sustaining the constitutionality of this statute the Court emphasized (p. 393) that the provisions thereof were expressly "applicable only to sales or transactions in, or directly or intimately affecting, interstate commerce". The operative effect of the Bituminous Coal Act is thus sharply contrasted with Section 11(b)(1) of the Act here involved, which not only is not limited to matters affecting interstate commerce but does not even purport to be a regulation of such commerce.

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U. S. v. *Rock Royal Co-op.*, 307 U. S. 533 (1939), and *U. S.* v. *Wrightwood Dairy Co., supra,* involved the Agricultural Marketing Agreement Act of 1937 (50 Stat. 246) which granted authority to the Secretary of Agriculture (see 315 U. S. at p. 116) to regulate any agriculture commodities "in the current of interstate or foreign commerce, or which directly burdens, obstructs, or affects" such commerce.

In the *Rock Royal* case, which dealt with prices for milk in the New York area, the Court upheld the Secretary's power to deal with local sales because the Secretary had found as a fact (see 307 U. S. at pp. 551-553) that two-thirds of the milk in the New York area came to said area from or through other States and that the other third, produced in New York, became "physically and inextricably intermingled" with the "interstate milk", and that "all was handled either in the current of interstate commerce or so as to affect, burden and obstruct such interstate commerce in milk and its products." In this connection, the Court said (p. 569):

> "• • • Where local and foreign milk alike are drawn into a general plan for protecting the interstate commerce in the commodity from the interferences, burdens and obstructions, arising from excessive surplus and the social and sanitary evils of low values, the power of the Congress extends also to the local sales."

In the *Wrightwood Dairy Co.* case this Court upheld Federal regulation of local sales of milk in the Chicago area, the Secretary having found (see 315 U. S. at pp. 117-118) that 60% of the milk in the area in question was produced in Illinois and 40% in neighboring States, that all of the milk in question was "handled in the current of interstate

commerce, or so as directly to burden, obstruct, or affect interstate commerce in milk or its products", that the "local" milk of the respondent was sold in Illinois "in competition" with interstate milk, and that by reason of its competition with the handling of the interstate milk it so affected interstate commerce as substantially to interfere with its regulation.

The *Rock Royal* and the *Wrightwood Dairy Company* cases involved a statute which was in express terms limited to matters affecting interstate commerce, and the findings of the Secretary provided a definite factual basis for concluding that regulation of the local transactions involved was necessary to make effective the regulation which Congress had provided for interstate transactions. Section 11(b)(1), however, contains no such limitation as is found in the Agricultural Marketing Agreement Act, nor are there any findings in the case at bar which are comparable to the findings made by the Secretary of Agriculture in the *Rock Royal* and *Wrightwood Dairy Co.* cases.

Wickard v. *Filburn, supra,* involved the Agricultural Adjustment Act of 1938 and an amendment thereof (52 Stat. 31; 55 Stat. 203). In that statute Congress declared (52 Stat. at pp. 52-53) that wheat is a basic source of food; that wheat or flour "flows almost entirely through instrumentalities of interstate and foreign commerce from producers to consumers"; that "Abnormally excessive and abnormally deficient supplies of wheat on the country-wide market acutely and directly affect, burden, and obstruct interstate and foreign commerce"; and that the provisions of the statute for the regulation of marketings by producers of wheat "whenever an abnormally excessive supply of such commodity exists are necessary in order to maintain an orderly flow of wheat in interstate and foreign

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commerce." The question before this Court was whether Filburn's wheat, which was home grown for home consumption, could be said to affect interstate commerce sufficiently to make the application of the statute to him constitutional. There was in the record a stipulation of the economic facts (see 317 U. S. at p. 114) on the basis of which this Court found as follows (317 U. S. at pp. 128-129):

> "This record leaves us in no doubt that Congress may properly have considered that wheat consumed on the farm where grown, if wholly outside the scheme of regulation, would have a substantial effect in defeating and obstructing its purpose to stimulate trade therein at increased prices."

Wickard v. *Filburn* is thus but another illustration of a situation where local and interstate transactions of the same general character are so interrelated that it is impossible to regulate the latter without regulating the former, and where this Court has sustained Federal regulation of the local activities upon the basis of specific, factual findings, or legislative declarations, to this effect.

Plainly, such a decision affords no support for the decision of the court below in the case at bar. Section 11(b)(1) of the Act is not limited in its effect to matters which affect interstate commerce. Indeed, it does not even purport to be a regulation either of interstate commerce or of intrastate matters which are stated to affect interstate commerce. Moreover, there is no finding of any kind that the ownership by Engineers of the securities of which the challenged order requires divestment affects interstate commerce; *and there is nothing in the record upon the basis of which this Court could make such a finding.*

In its brief (dated April, 1943) in the *North American Company* case, No. 1, present Term, (No. 6, October Term,

1943) the Commission cites *United States* v. *Ferger, supra*, *Virginian Ry.* v. *Federation*, 300 U. S. 515 (1937), and *Colorado* v. *United States*, 271 U. S. 153 (1926), as illustrations of cases involving statutes which contain no statement by Congress that the activity regulated is related to interstate commerce, and therefore as holding that "the finding must therefore have been implied from the mere enactment of the statute and from the character of the regulation implied." Brief analysis of these cases, however, shows not only that they fail to support the proposition for which they are cited but that they lend no support to the decision of the court below.

The *Ferger* case as pointed out above (p. 22, *supra*), involved a statute dealing with the issuance of spurious bills of lading purporting to be used in interstate commerce, and was designed (see 250 U. S. at 205) to protect "the vast volume of interstate commerce operating and moving in reliance upon genuine bills." In that case the Court took judicial notice of the fact that bills of lading for the movement of interstate commerce are instrumentalities of that commerce, saying (p. 204) that this was "too clear for anything but statement." Plainly, in such a case, legislative findings as to the relationship to interstate commerce would be superfluous. In the case at bar, however, there are no facts of common knowledge upon the basis of which any court could find that the ownership of the securities here ordered divested substantially affects interstate commerce.

Colorado v. *United States, supra*, involved the validity of a certificate issued by the Interstate Commerce Commission permitting the abandonment of an intrastate branch line. The certificate was issued by the Commission upon the basis of specific findings, among others, that the operation of said branch line had resulted in large deficits for

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years and that future operation would also result in deficits, so that "continued operation would constitute an undue burden upon interstate commerce" (see 271 U. S. at pp. 160, 163). That case is obviously one falling in the category where, under the statute, an administrative agency is vested with jurisdiction to determine the effect of the particular activity upon interstate commerce. Under the Act here involved, no such jurisdiction is vested in the Commission; and none was even attempted to be exercised.

Virginian Ry. v. *Federation, supra,* involved the constitutionality of the Railway Labor Act (44 Stat. 577; 48 Stat. 1185), which requires the railways to "treat with" employees certified by the Mediation Board as representatives of a craft or class. The issue was whether the statute could be applied to "back shop" employees engaged solely in intrastate commerce. In the statute Congress stated (see 300 U. S. at p. 553) as its purposes, among others, "To avoid any interruption to commerce or to the operation of any carrier engaged therein" and "to provide for the prompt and orderly settlement of all disputes concerning rates of pay, rules or working conditions." Both courts below specifically found (p. 556) that "interruption by strikes of the back shop employees, if more than temporary, would seriously cripple petitioner's interstate transportation." In holding that the statute was constitutional as applied to the "back shop" employees, the Court said (p. 553):

> "The provisions of the Act and its history, to which reference has been made, establish that such are its purposes. . . . It was for Congress to make the choice of the means by which its objective of securing the uninterrupted service of interstate railroads was to be secured, *and its judgment, supported as it is by our long experience with industrial disputes, and*

> *the history of railroad labor relations, to which we have referred,* is not open to review here. . . ."

The statute's specific declaration of an "interstate" purpose (*i.e.*, to prevent interruption of interstate commerce by providing means for avoiding disputes, etc.) and the specific factual findings by the trial court in the *Virginian Ry.* case sharply distinguished that case from the case at bar.

In the court below, and in its brief (dated April, 1943) in the *North American Company* case in this Court (at pp. 78-79), the Commission cited, as sustaining the validity of the divestment provisions of Section 11(b)(1), cases under the Sherman Act, the Clayton Act, and the Commodities Clause of the Hepburn Act, such as *Northern Securities Co.* v. *United States*, 193 U. S. 197 (1904), *United States* v. *Delaware & Hudson Co.*, 213 U. S. 366 (1909), and *Standard Oil Co.* v. *United States*, 221 U. S. 1 (1911). Such decisions have no bearing upon the instant case. The statutes there involved specifically prescribe rules for the conduct of interstate commerce or of matters affecting such commerce, and under those statutes it is left to the courts to determine whether the particular activities in question have the prohibited effect upon interstate commerce. In all cases of that type the exertion of the federal power is necessarily predicated upon *a judicial finding that the required effect upon interstate commerce is present.* There is no such finding in the case at bar and the Act does not provide for any such finding. See *U. S.* v. *Underwriters Assn.*, 322 U. S. 533, 553 (1944).

The only case in which this Court has considered the constitutionality of any part of the Act, *Electric Bond Co.* v. *Comm'n, supra,* is fully in accord with Petitioners' contentions. This Court there held that the registration provisions in Sections 4(a) and 5 were separable from the

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remainder of the Act, and that said registration provisions, separately considered, were within the commerce power. As pointed out above (Point I, C), the Court specifically reserved decision as to the validity of the other provisions of the Act, and, so far as Section 11(b)(1) is concerned, quoted with approval (see 303 U. S. at p. 436) the District Court's statement that——

> "... §1 (c) in its entirety negatives any conclusion that the simplification and elimination of holding companies 'is the sole policy or the whole end and object of the Act, which, as stated, is "to meet the problems and eliminate the evils, as enumerated in this section, connected with public utility holding companies,"' and thus 'simplification and elimination' are but a means and not 'the exclusive means' deemed to be essential for the purpose of effectuating such policy 'in whole or in so far as may be constitutionally possible'."

The Court's conclusion was (at p. 441) "that from these defendants, with their highly important relation to interstate commerce and the national economy, Congress was entitled to demand the fullest information as to organization, financial structure and all the activities which could have any bearing upon the exercise of congressional authority"; and it emphasized (at p. 442) that the registration provisions went "no further than to require this information." In this connection it is to be noted that the Court's finding that the defendants were engaged in interstate commerce was predicated on what the Court described (at pp. 431, 440) as an "elaborate stipulation" relating to the activities of the holding company and its subsidiaries and "findings of fact" by the trial court based thereon. In the instant case there is no such stipulation of agreed facts and neither the Commission nor the court below made any comparable findings.

Moreover, it is clear that Congress can require the furnishing of information from persons whose activities touch interstate commerce only remotely, and in fact can require information to be furnished for the purpose of determining its jurisdiction in the premises. See *Newport News Co.* v. *Schauffler*, 303 U. S. 54, at p. 58 (1938); *Electric Bond Co.* v. *Comm'n, supra*, at p. 437.

All of the above cases fall within the definite limits for determining the extent of Federal control over purely local activities outlined by this Court in the *Darby* case. The case at bar, however, falls outside such limits. Never before has an attempt been made to predicate Federal regulation of all the units of an industry upon the strength of a legislative declaration (unsupported by any complementary findings of a court or administrative tribunal) that the activities of *some* units of such industry affect interstate commerce or that the activities of the members of such industry sometimes or "often" affect interstate commerce. *A fortiori*, no attempt has ever before been made on the basis of any such legislative declaration to sustain Federal control of purely local activities which on their face could not be held to affect interstate commerce even if the Congress had so declared (Point I, A, *supra*).

As indicated above (Point I, B), the most far-reaching of the legislative "findings", so far as Section 11(b)(1) is concerned, is the declaration in Section 1(a)(4) that the "practices" of holding companies "in respect of and control over subsidiary companies *often* materially affect the interstate commerce in which those companies engage." Whatever scope should be given to this declaration, it clearly has no relevance with respect to ownership of securities of subsidiary companies which do not engage in interstate commerce. Petitioners contend that the attempted inclusion within the scope of Section 11(b)(1) of a single

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property, such as the Lake Charles water property, which demonstrably is not engaged in interstate commerce and does not in any way affect such commerce, can have no effect other than to place Section 11(b)(1) beyond the scope of the Federal power, notwithstanding the separability provisions in Section 32 of the Act. This follows because the Act provides no mechanism whatever for separating the operative effect of Section 11(b)(1) as between properties affecting interstate commerce and those which have no such effect. The Commission itself has recognized the impossibility of endeavoring to separate Section 11(b)(1) as to matters affecting interstate commerce and matters not affecting such commerce by stating, in its brief below, that it would have been "improper" for the Commission to make any findings with respect to interstate commerce.

Light on this last point is afforded by other provisions of the Act. Wherever in the Act an activity by registered holding companies and their subsidiaries is prohibited unless certain conditions are complied with, the activity is expressly made unlawful if done "by the use of the mails or any means or instrumentality of interstate commerce, *or otherwise.*" [See, for example, Sections 6(a), 9(a)(1), 11(g), 12(a), 12(b), 12(c), 12(d), 12(e), 12(f), 12(g), 12(h), several places in Section 13 and other places in the Act.] The use of the words "or otherwise" in said phrase renders wholly meaningless and unnecessary all the preceding words therein unless the draftsman of the Act, having constitutional doubts in mind, intended to permit a ready judicial separation of interstate activities from other activities by the simple device of striking out the words "or otherwise", thus limiting the phrase to matters within the Federal power. In Section 11(b)(1), however, neither this phrase nor any comparable saving phrase is used. Section

11(b)(1), therefore, must stand or fall as an entirety. *Lemke* v. *Farmers Grain Co.*, 258 U. S. 50, 60 (1922); *Williams* v. *Standard Oil Co.*, 278 U. S. 235, 241 (1929); *United States* v. *Butler*, 297 U. S. 1, 58 (1936); *Carter* v. *Carter Coal Co.*, 298 U. S. 238, 312 *et seq.* (1936); *cf. State of North Carolina* v. *United States*, No. 560, October Term, 1944, decided June 11, 1945.

Time and again this Court has emphasized the salutary principle that Federal control may not be exerted over intrastate affairs unless the constitutional justification for such control unmistakably appears. Thus, in *State of North Carolina* v. *United States*, No. 560, October Term, 1944, decided June 11, 1945, in which an order of the Interstate Commerce Commission prescribing intrastate rates was held to be invalid because of the lack of "clear findings, supported by evidence", the Court said:

> "Intra-state transportation is primarily the concern of the state. * * * Before the Commission can nullify a state rate, justification for the 'exercise of the federal power must clearly appear'."

Similarly, in *Connecticut Co.* v. *Power Comm'n*, 324 U. S. 515 (1945), the Court said (p. 532):

> "* * * Nothing except explicit findings excluding the grounds of state control gives assurance that the bounds of federal jurisdiction have been accurately understood and fully respected, and that state power has been considerately and deliberately overlapped."

See also, *Polish Alliance* v. *Labor Board*, 322 U. S. 643 (1944), where this Court said that (pp. 652-653):

> "* * * It has insisted upon 'suitable regard to the principle that whenever the federal power is exerted within what would otherwise be the domain

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of state power, the justification of the exercise of the federal power must clearly appear.' * * *"

If vague and equivocal declarations as to interstate commerce such as appear in Section 1(a)(4) of the Act are held adequate to warrant the sweeping divestment provisions of Section 11(b)(1) as a regulation of interstate commerce, there will have come into being a conception of the Federal commerce power as extending to the control of the ownership of all properties whenever deemed necessary by Congress for the general welfare. If control of the ownership of property is vested in Congress regardless of the effect of such ownership on interstate commerce, all limitation upon the exercise of the commerce power will have disappeared, and, with it, the traditional separation of powers between the States and the Nation.[10]

Summarizing Point I, we submit that Section 11(b)(1) is not supportable under the commerce power because—

(1) the power of divestment granted to the Commission thereby applies to all properties owned by public-utility holding companies regardless of whether the ownership of such properties constitutes or affects interstate commerce;

(2) Section 11(b)(1) does not contain an unequivocal finding that the control of all public-utility holding com-

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[10] We have not, except quite incidentally, discussed the power of Congress over the mails, since it is not reasonably conceivable that a divestment power such as contained in Section 11(b)(1) could possibly be sustained under the postal power just because a holding company and its subsidiaries may use the mails incidentally in carrying on their businesses. That the use of the mails in such case can be regulated is clear, but to rely on the use of the mails as a pretext to support wholesale divestments of property such as authorized by Section 11 (b)(1) would be clearly an abuse of the mail power. "* * * Congress may not exercise its control over the mails to enforce a requirement which lies outside its constitutional province, * * *." *Electric Bond Co.* v. *Comm'n*, 303 U. S. 419, at p. 442.

panies over their subsidiaries, or the ownership by all such holding companies of securities of their subsidiaries, constitutes or affects interstate commerce, and no such finding would be true in fact;

(3) Section 11(b)(1) provides no machinery for a finding by the Commission or any other tribunal that the ownership of properties sought to be divested thereunder constitutes or affects interstate commerce, and no such finding was made in the case at bar;

(4) no presumption can be indulged to the effect that the ownership of the securities here involved affects interstate commerce from the mere fact of Engineers' registration under the Act or from its failure to apply for exemption thereunder since registration may be forced or exemption denied on grounds having no relation whatever to interstate commerce; and

(5) the decision of the court below extends the commerce power far beyond the limits established by repeated decisions of this Court.

II

Section 11(b)(1) violates the due process clause of the Fifth Amendment

The due process clause of the Fifth Amendment requires that the challenged law shall not be "unreasonable, arbitrary or capricious and that the means selected shall have a real and substantial relation to the object sought to be obtained." *Nebbia* v. *New York*, 291 U. S. 502, 525 (1934); *Retirement Board* v. *Alton R. Co.*, 295 U. S. 330, 347-348 (1935); *cf.*, *Power Comm'n* v. *Pipeline Co.*, 315

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U. S. 575, 582-583 (1942).[11] While, concededly, the due process concept is not governed by "mathematical or rigid formulas" (*Santa Cruz Co.* v. *Labor Board*, 303 U.S. 453, 467), there can be no doubt that such concept does impose limitations upon Federal action under the commerce power.

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[11] In effect, this doctrine was enunciated as early as 1877 when, in *Railroad Co.* v. *Husen*, 95 U. S. 465, in holding unconstitutional a State cattle quarantine statute, this Court explicitly rejected the contention that the reasonableness of police power legislation is exclusively for the legislature. The Court there said (pp. 473-474):

> "* * * The police power of a state cannot obstruct foreign commerce or inter-state commerce beyond the necessity for its exercise; and *under color of it objects not within its scope cannot be secured at the expense of the protection afforded* by the Federal Constitution * * *."

In the same year the Court stated in a dictum, in *Davidson* v. *New Orleans*, 96 U. S. 97, at p. 102:

> "* * * can a State make anything due process of law which, by its own legislation, it chooses to declare such? To affirm this is to hold that the prohibition to the States is of no avail, or has no application where the invasion of private rights is effected under the forms of State legislation. It seems to us that a statute which declares in terms, and without more, that the full and exclusive title of a described piece of land, which is now in A., shall be and is hereby vested in B., would, if effectual, deprive A. of his property without due process of law, within the meaning of the constitutional provision."

When it is considered that the Fourteenth Amendment was not adopted until 1866 and that during the first one hundred years of the nation's history neither Congress nor the States undertook any comprehensive regulatory programs, it appears that the principle of "judicial review" was recognized as a part of our law from the time it was first essential that such principle be decided; and the principle has since been consistently followed. See, for example, *Mugler* v. *Kansas*, 123 U. S. 623, 661 (1887); *Lawton* v. *Steele*, 152 U. S. 133, 136 (1894); *Dobbins* v. *Los Angeles*, 195 U. S. 223, 235 (1904); *Jacobson* v. *Massachusetts*, 197 U. S. 11, 38 (1905); *Lochner* v. *New York*, 198 U. S. 45, 56 (1905); *Silz* v. *Hesterberg*, 211 U. S. 31 (1908); *Rast* v. *Van Deman & Lewis*, 240 U. S. 342, 366 (1916); *Block* v. *Hirsh*, 256 U. S. 135, 154 (1921); *Wolff Co.* v. *Industrial Court*, 262 U. S. 522, 536 (1923); *Norfolk Ry.* v. *Public Serv. Comm.*, 265 U. S. 70, 74 (1924); *Burns Baking Co.* v. *Bryan*, 264 U. S. 504, 513 (1924); *Weaver* v. *Palmer Bros. Co.*, 270 U. S. 402, 410 (1926); *Tyson & Brother* v. *Banton*, 273 U. S. 418, 431 (1927); *New State Ice Co.* v. *Liebmann*, 285 U. S. 262, 278-279 (1932); *Borden's Co.* v. *Baldwin*, 293 U. S. 194, 209-210 (1934); *Mayflower Farms* v. *Ten Eyck*, 297 U. S. 266 (1936); *U. S.* v. *Carolene Products Co.*, 304 U. S. 144, 152 (1938).

Monongahela Navigat'n Co. v. *United States*, 148 U. S. 312, 336 (1893); *United States* v. *Cress*, 243 U. S. 316, 328 (1917); *Louisville Bank* v. *Radford*, 295 U. S. 555, 589 (1935); *U. S.* v. *Appalachian Power Co.*, 311 U. S. 377, 427 (1940).

Petitioners contend that such limitations have been exceeded by Section 11(b)(1).

A. Section (11)(b)(1) Takes the Property of Petitioners for a Public Use Without the Payment of Just Compensation

Since the effect of the challenged orders is retroactively to confiscate important property rights, lawfully acquired and held by Petitioners for many years under State laws, without conferring any benefit upon them and without providing for any compensation, Petitioners contend, first, that Section 11(b)(1) is not a legitimate means for effectuating the purposes of the Act but rather an unconstitutional taking of their property.

The Circuit Court of Appeals in the *North American Company* case stated (133 F. (2d) at p. 154) that "Compelling the holding company to dispose of its securities is not the same as condemning private property for public use without paying just compensation." This, we submit, is an undue simplification which evades rather than answers the judicial inquiry. The constitutional prohibition against deprivations of property is not limited to physical condemnations. *C. B. & Q. Railway* v. *Drainage Comm'rs.*, 200 U. S. 561, 593 (1906); *Hudson Water Co.* v. *McCarter*, 209 U. S. 349, 355 (1908); *Oregon R. R. & N. Co.* v. *Fairchild*, 224 U. S. 510, 523-524 (1912); *Block* v. *Hirsh*, 256 U. S. 135, 156 (1921); *Penna. Coal Co.* v. *Mahon*, 260 U. S. 393 (1922); *Del., L. & W. R. R.* v. *Morristown*, 276 U. S. 182, 194-195 (1928); *Panhandle Co.* v. *Highway Comm'n.*, 294 U. S. 613

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(1935); *U. S.* v. *General Motors Corp.*, 323 U. S. 373, 378, 383-384 (1945)

As stated in *C. B. & Q. Railway Co.* v. *Drainage Comm'rs., supra,* at page 593:

> "The constitutional requirement of due process of law, which embraces compensation for private property taken for public use, applies in every case of the exertion of governmental power. . . . If the means employed . . . are arbitrary and unreasonable, beyond the necessities of the case, the judiciary will disregard mere forms and interfere for the protection of rights injuriously affected by such illegal action."

Very recently this Court in *U. S.* v. *General Motors Corp.*, 323 U. S. 373 (1945), *supra,* pointed out (p. 378) that—

> "In its primary meaning, the term 'taken' would seem to signify something more than destruction, for it might well be claimed that one does not take what he destroys. But the construction of the phrase has not been so narrow. The courts have held that the deprivation of the former owner rather than the accretion of a right or interest to the sovereign constitutes the taking. * * *",

and, further (p. 384), that "destruction is tantamount to taking."

To the same effect, it was pointed out by Mr. Justice Holmes in *Penna. Coal Co.* v. *Mahon,* 260 U. S. 393, 415 (1922), that although "property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." In that case the Court pointed out (p. 414) that "To make it commercially impracticable to mine certain coal has very nearly the same effect for constitutional purposes as appropriating or destroying it." In the same

manner, "Compelling the holding company to dispose of its securities" has the same effect as a "taking" of such securities if, as a necessary result of such enforced disposition, the holding company and its stockholders are permanently deprived of "rights in specific property which are of substantial value."

Authority for this conclusion is found in *Louisville Bank* v. *Radford*, 295 U. S. 555 (1935), where this Court held the first Frazier-Lemke Act unconstitutional as the taking of property without just compensation as against a mortgagee suing to foreclose a farm mortgage entered into prior to enactment of the statute. The first Frazier-Lemke Act provided that a farmer in default on his mortgage could resort to a bankruptcy court which was authorized to permit the farmer, with the approval of the mortgagee, to purchase the property subject to the mortgage at its appraised value through deferred payments over a six year period. If the mortgagee did not acquiesce in this procedure, the court was authorized to stay foreclosure proceedings for five years, with the farmer having the right to remain in possession upon payment of a "reasonable rental". The farmer was given the right, at any time during such period, to pay the appraised value of the property to the court, and such payment discharged the mortgage debt. The contentions advanced in support of this statute, which are to be compared with those advanced by the Commission in the present case, were summarized by the Court as follows (pp. 598-599):

> "• • • Radford contends further that the changes in the mortgagee's rights in the property, even if substantial, are not arbitrary and unreasonable, because they were made for a permissible public purpose. That claim appears to rest primarily upon the following propositions: (1) The welfare

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of the Nation demands that our farms be individually owned by those who operate them. (2) To permit widespread foreclosure of farm mortgages would result in transferring ownership, in large measure, to great corporations; would transform farmer-owners into tenants or farm laborers; and would tend to create a peasant class. (3) There was grave danger at the time of the passage of the Act, that foreclosure of farms would become widespread. . . . (4) Thus had arisen an emergency requiring congressional action. To avert the threatened calamity *the Act presented an appropriate remedy.* Extensive economic data, of which in large part we may take judicial notice, were submitted in support of these propositions."

In rejecting these contentions and holding the law invalid because it retroactively deprived the mortgagee of his property rights, the Court said (pp. 601-602):

"We have no occasion to consider either the causes or the extent of farm tenancy; or whether its progressive increase would be arrested by the provisions of the Act. Nor need we consider the occupations of the beneficiaries of the legislation. These are matters for the consideration of Congress; and the extensive provision for the refinancing of farm mortgages which Congress has already made, *shows that the gravity of the situation has been appreciated.* The province of the Court is limited to deciding whether the Frazier-Lemke Act as applied has taken from the Bank without compensation, and given to Radford, rights in specific property which are of substantial value . . . (citing cases). As we conclude that the Act as applied has done so, we must hold it void. *For the Fifth Amendment commands that, however great the Nation's need, private property shall not be thus taken even for a wholly public use without just compensation.*"

(See also, *Monongahela Navigat'n Co.* v. *United States*, 148 U. S. 212 (1893), *supra*.

The similarities between the statute in the *Radford* case and that in the present case are striking. Both statutes operate retroactively. In the *Radford* case, the mortgage had been lawfully acquired prior to enactment of the challenged law; here, too, the properties required to be divested were lawfully acquired, and for many years lawfully held, prior to enactment of Section 11(b)(1). In the *Radford* case some of the rights under the mortgage were taken away from the mortgagee and given to the mortgagor. Likewise in the present case, important rights of Engineers are either taken away from it and given to others or are wholly destroyed.

Engineers has outstanding more than $39,000,000 of preferred stock which is preferred as to assets over the common stock at $100 per share (R. 34, Ex. F-1; pp. 9553, 9561 of transcript filed in court below). Being stock and not a debt, that security has no "maturity" date; and the right of Engineers to use in its business the proceeds of that stock continues indefinitely into the future. The challenged order in the case at bar will have the effect, *regardless of how it is carried out*, of taking such right to use those proceeds away from Engineers and transferring it to the preferred stockholders. This deprivation of Engineers' right, lawfully acquired by it prior to the passage of Section 11(b)(1), to use indefinitely in its business the proceeds of its preferred stock is a taking of property of exactly the same character as that held to be unconstitutional in the *Radford* case.

A further important right of which Engineers, its subsidiaries, and their respective stockholders, are deprived by Section 11(b)(1) is the valuable element of "diversity" which they now possess, under the applicable State laws,

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by virtue of Engineers' ownership of at least three utility systems located in three different sections of the country. Each of these three systems is subject to different economic and other influences. One of these systems (Virginia) is located in Virginia, West Virginia and North Carolina. In this section there are diversified industries, and tobacco is an important agricultural product. Another system (Gulf States) is located in eastern Texas and Louisiana where oil production and processing is the principal industry and rice an important agricultural product. The third system (El Paso (Texas)) is located in western Texas and New Mexico where cattle raising, the refining of ores and the raising of cotton are the principal activities.

A public utility depends for its prosperity upon economic and other factors in the region where it is located. The geographic and economic diversity of these three utility systems of Engineers provides an important stabilizing factor affecting not only the production of electricity and gas but continuity of earning power. In addition, it makes possible an overall supervisory management which insures the competent operation and sound financing of the diversified operating properties. By the challenged divestment order Engineers is required to sell or dispose of two of these three systems and confine its operations to the single region of Virginia, West Virginia and North Carolina. If Petitioners are compelled to conform to this order the inevitable result, *no matter how or when the order is carried out,* will be the destruction and loss of all those important elements of value which arise from the geographic and economic diversity of the Engineers system. This loss will fall not only upon Engineers but also upon its subsidiaries and the stockholders of both.

A further valuable right of which Petitioners will be deprived by Section 11(b)(1) is the basic privilege of any owner, accorded by State laws, to continue to own the property held by him,—a privilege which carries with it the right to select the time when, if at all, he shall dispose thereof.

In this connection, Petitioners emphasize, first, the inevitable destruction of values incident to the *compulsory* divestment by Engineers of investments having a value in excess of $30,000,000 (R. 253). There are only two ways in which the divestment order may be carried out, *i.e.*, by liquidation of the assets of Engineers or by a distribution of such assets in kind. Whatever method is followed, the priority of the Engineers' preferred stock must be recognized. If the securities which are subject to the divestment order are sold or distributed among the stockholders by Engineers under compulsion of the divestment order, or by a trustee appointed by a court in a proceeding under Section 11(d) to enforce the order, the preferred stock will be entitled to receive cash equivalent to its liquidation value or the equitable equivalent thereof before any distribution is made on the common stock. See *Otis & Co.* v. *S. E. C.*, 323 U. S. 624 (1945). In either event, the inevitable result will be a serious destruction of property values *quite apart from the losses incident to the breaking-up of the holding company system.*

While, as above indicated, the principal vice of the divestment order is not the fact that it requires divestment as of some particular time, nevertheless this is a factor which sharply emphasizes Petitioners' claim of confiscation. Because of continual and wide fluctuations in price levels and business activities, determination of the time when property shall be sold is an important element of value attaching to ownership. Under Section 11(b)(1) that

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element of value is taken from Petitioners and the right to determine the time to sell is given to the Commission or to a trustee appointed by a court in a proceeding under Section 11(d). Here, again, the condition of the market at the particular moment of sale is of no relevance. If such market is "high", it may be still higher at a later date.

In the court below the Commission suggested that Engineers could not properly complain of hardships incident to compliance with the challenged orders, because it had been on notice since 1935 that it might have to divest itself of some of its properties under Section 11(b)(1). This suggestion completely ignores the fact that no matter when or how the divestment order is effectuated, the result will be the permanent loss of valuable property rights. Moreover, the suggestion is quite irrelevant. Pursuant to its undoubted rights, if not a duty to its security holders, Engineers is before this Court, raising serious questions as to the constitutionality and construction of the statute; and it does not know yet whether or not it is required to dispose of any of its properties and, if so, which ones. To say that Engineers should heretofore have divested itself of its properties is tantamount to saying that it had no right to raise the issues here presented.

It is no answer to Petitioners' contentions to say that Section 11(b)(1) was deemed necessary by Congress to eliminate "abuses" or "evils" in the holding company field for the welfare of the nation at large.[12] It was precisely contentions of this character which were rejected in the *Radford* case, where the Court pointed out (295 U. S. at p. 602) that the "Fifth Amendment commands that, however great the Nation's need, private property shall not be thus

[12] In this connection it should be noted that there have been no findings by the Commission or the court below that *Petitioners* have been guilty of any of the alleged "abuses" or "evils".

taken even for a wholly public use without just compensation." As stated by Mr. Justice Holmes in *Penna. Coal Co. v. Mahon*, 260 U. S. 393, at p. 416 (1922), ". . . a strong public desire to improve the public condition is not enough to warrant achieving the desire by a shorter cut than the constitutional way of paying for the change."

B. The Provisions of Section 11(b)(1) Do Not Have Any Real or Substantial Relation to the Purposes of the Act

Before the Commission Petitioners offered to prove, as a fact, that the provisions of Section 11(b)(1) are arbitrary and unreasonable, and hence unconstitutional, in that they have no relationship to the legislative objectives (R. 248-251, 893-1140). The Commission refused to receive this evidence on the ground that it was without power to pass upon the constitutionality of the Act (R. 163-164, 248-252, 289); and the court below sustained this action (R. 1232-1234).

The proffered evidence, which appears in full in the record (R. 893-1140), is summarized in Appendix A to this brief, and described under Point III, *infra*, where Petitioners contend that the Commission's rejection of this evidence was not only erroneous but a clear violation of their rights under the Fifth Amendment, which in and of itself requires that the proceedings be remanded.

Since neither the Commission nor the court below passed upon the effect of the proffered evidence, we do not believe that this Court can deal with that question. If, however, such evidence may be considered as being before this Court, we point out that it stands uncontradicted by any other evidence in or outside the record, and that it establishes factually, as shown under Point III, *infra*, that there is no

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real or substantial relationship between the remedial devices of Section 11(b)(1) and the statutory objectives.

But wholly apart from the proffered evidence, Petitioners contend that Section 11(b)(1) violates the due process clause because it appears on the face of Section 11(b)(1), and from facts subject to judicial notice, that it imposes severe and restrictive prohibitory devices which are quite unnecessary for accomplishment of the legislative objectives in view of other applicable legislation, including other provisions in the same Act.

The policy of the Act, as stated in Section 1(c), is to eliminate specified "evils" or "abuses" which are enumerated in five numbered sub-paragraphs of Section 1(b). To effectuate this policy, Congress selected two procedures, i.e., divestment of assets and reorganization under Section 11(b)(1) and Section 11(b)(2), and comprehensive regulation of holding companies and subsidiaries under other sections of the Act. A review of such other provisions demonstrates that they deal specifically and comprehensively with every "evil" or "abuse" mentioned in Section 1(b).

Thus, the asserted inadequacy of "information necessary to appraise the financial position or earning power" of utility companies [Sec. 1(b)(1)] is dealt with by Section 5 of the Act which provides that a registered holding company must file complete information concerning itself and its subsidiaries; by Section 7, which prohibits a holding company or a subsidiary from issuing securities unless detailed information is filed with the Commission; by Section 10, which prohibits the acquisition of securities or utility assets without Commission approval and the filing of detailed information; by Section 14, which requires a holding company to file annual and other reports as ordered by the Commission, which reports, under Section 22, are

available to the public unless the Commission otherwise directs; by Section 15, which provides that registered holding companies and subsidiaries shall maintain accounts and records as prescribed by the Commission; and also by numerous provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, the Federal Power Act, and State utility commission laws. It is safe to say that today there is not a private utility system of any consequence in the country in respect of which the fullest information is not available in public records.

The asserted unregulated issuance of securities, the issuance of securities upon capitalization of fictitious values, and the issuance of securities upon over-capitalizations to prevent voluntary rate reductions [Sec. 1(b)(1)] are specifically dealt with in Sections 6 and 7 of the Act, which prohibit the sale of securities by holding companies and their subsidiaries without the approval of the Commission, as well as by Section 204 of the Federal Power Act [16 U. S. C. A. §824(c)] which requires Federal Power Commission approval of security issues of interstate utility companies except when the company is organized and operating in a State which itself regulates security issues.

The asserted excessive service and other charges by holding companies to their subsidiary companies and lack of effective State regulation of service charges [Sec. 1(b)(2)] are specifically dealt with by Section 13, which either prohibits such charges or brings them under comprehensive Commission regulation.

The asserted abuse of holding company control over the accounts, rates and dividends of operating companies [Sec. 1(b)(3)] is dealt with by Section 12(c), which provides for control of the dividend policies of holding com-

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panies and their subsidiaries, and by Section 15, which provides for complete control of accounting practices both of holding companies and subsidiaries. Operating company rates are, of course, subject either to Federal Power Commission, State Commission or municipal control.

The asserted control of operating companies through disproportionately small investments [Sec. 1(b)(3)] is subject to comprehensive regulation by the Commission under Sections 7, 10, 12 and 13.

The asserted growth of holding companies unrelated to the integration and coordination of related operating companies is wholly subject to the Commission's control under Sections 9 and 10. Moreover, existing lack of integration and coordination is subject to regulation by the Federal Power Commission which, under Section 202(b) of the Federal Power Act [16 U. S. C. A. §824(b)], may compel the physical interconnection of interstate electric power companies.

And, finally, as to the asserted lack of economy of management, lack of efficiency, inadequacy of service, and lack of effective regulation, the Commission possesses broad powers to deal with those problems under a host of sections of the Act, including, in addition to those already mentioned, Section 13(e) under which the Commission controls "costs" of service rendered by any "affiliate" with respect to effectiveness of regulation.

It is clear that by virtue of the Act the regulation of utility companies subject to the Act is, to say the least, as comprehensive and effective as it would be if, by virtue of a divestment order under Section 11(b)(1), the regulation of such companies were restored to the States.

The comprehensive scope of the regulatory provisions of the Act is apparent upon the mere reading of the same. Their effectiveness in actual practice is emphasized in the

annual reports, releases and other statements issued by the Commission and the Federal Power Commission. Thus, the Eighth Annual Report of the Commission (for the year ended June 30, 1942) indicates, among other things: that as of June 30, 1942, there were registered under the Act 134 holding companies, constituting 53 public-utility holding company systems, with assets representing about 68% of the total private industry (p. 19). From the Seventh Annual Report of the Commission (for the year ended June 30, 1941), it also appears among other things: that through control of security issues under Section 7 of the Act the Commission "has continued to strengthen the terms of the issues to the point where investors and consumers receive the protection intended by the Act" (p. 90); that the provisions of the Act provide "ample authority for meeting the problem" of the absence of free market competition in utility security underwriting through the adoption of Rule U-50, the competitive bidding rule (p. 99); that under Section 12(c) and rules promulgated thereunder, as well as in passing upon security issues, the Commission exercises "supervision over the dividend and depreciation policies of utility companies to prevent impairment of working capital and maintain financial integrity" (p. 103); that the Commission is now dealing with the inter-company debt situation (pp. 104-109); and that "Distinct progress in the administration of service, sales, and construction contracts pursuant to Section 13 of the Act was recorded during the past fiscal year" (p. 109). The Ninth Annual Report of the Commission (for the year ended June 30, 1943) states that "continued progress was made during the past fiscal year in strengthening the financial structures of public utility operating companies" (p. 44); that generally speaking said improvement in public utility capital structures—

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> "has resulted from debt reduction, * * * from the elimination of write-ups, from increased provision for depreciation both as to current accruals and existing reserves, from improved mortgage indenture provisions, from the elimination in many instances of preferred stock dividend arrearages, and from the inclusion in corporate charters of improved protective provisions with respect to preferred stock";

that Sections 6 and 7 of the Act "are well designed for the achievement" of "control over security issues" (p. 71); and that the Commission's establishment of a Uniform System of Accounts as well as Annual Report Forms "have opened the books of service companies for inspection and analysis" (p. 79). The Federal Power Commission, in its Release No. 1472, March 26, 1941, issued in connection with its Twentieth Annual Report for 1940, states that "The development of effective accounting control of utilities and new techniques in the conduct of formal rate cases are among the means by which the Federal Power Commission is closing the loophole through which utilities operating in interstate commerce have escaped regulation. ..." In an article in the June 23, 1945, issue of the Electrical World, Mr. Basil Manly, Chairman of the Federal Power Commission, states that "the application of the uniform system of accounts has brought the electric utilities out of a precarious financial position and into the soundest financial position in their history".[13]

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[13] In this connection, it may be noted that the constitutionality of police power legislation is dependent upon its reasonableness in light of the facts as they exist at the time of the attempted enforcement thereof. As stated in *Nashville, C. & St. L. Ry.* v. *Walters*, 294 U. S. 405, 415 (1935):

> "A statute valid as to one set of facts may be invalid as to another. A statute valid when enacted may become invalid by change in the conditions to which it is applied."

The declared purpose of Section 11 was to "create conditions under which effective federal and state regulation will be possible" (S. Rept. No. 621, 74th Cong., 1st Sess., p. 11). When, however, Section 11(b)(1) is examined in the light of the complete and effective system of regulation of public utility holding companies and their subsidiaries under the numerous remedial provisions of the Act other than Section 11(b)(1), and under other applicable statutes, it clearly appears that Section 11(b)(1) imposes unnecessarily severe and restrictive prohibitory conditions, and for this reason alone must be deemed to be arbitrary and unreasonable and therefore violative of due process. *Penna. Coal Co.* v. *Mahon*, 260 U. S. 393 (1922); *Railroad Co.* v. *Husen*, 95 U. S. 465 (1877); *Dobbins* v. *Los Angeles*, 195 U. S. 223 (1904); *Wolff Co.* v. *Industrial Court*, 262 U. S. 522 (1923); *Burns Baking Co.* v. *Bryan*, 264 U. S. 504 (1924); *Nectow* v. *Cambridge*, 277 U. S. 183 (1928); *Seattle Trust Co.* v. *Roberge*, 278 U. S. 116 (1928); *New State Ice Co.* v. *Liebmann*, 285 U. S. 262 (1932).

A striking analogy is offered in *Liggett Co.* v. *Baldridge*, 278 U. S. 105 (1928), where this Court held invalid a Pennsylvania statute forbidding the ownership of pharmacies by corporations unless all members of the corporations were registered pharmacists. The Court reviewed the numerous Pennsylvania statutes regulating pharmacies and pointed out that in light of the complete and effective system of regulations in effect, the statutory provision prohibiting ownership by corporations could not be said to have any reasonable relationship to the protection of public health. The Court said (pp. 113-114):

> "The act . . . deals in terms only with *ownership*. It plainly forbids the exercise of an ordinary property right and, on its face, denies what the Constitution guarantees. A state cannot, 'under the guise of

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protecting the public, arbitrarily interfere with private business or prohibit lawful occupations or impose unreasonable and unnecessary restrictions upon them.' . . .

"*In the light of the various requirements of the Pennsylvania statutes,* it is made clear, if it were otherwise doubtful, that mere stock ownership in a corporation, owning and operating a drug store, can have no real or substantial relation to the public health; and that the act in question creates an unreasonable and unnecessary restriction upon private business. . . . The claim, that mere ownership of a drug store by one not a pharmacist bears a reasonable relation to the public health, finally rests upon conjecture, unsupported by anything of substance. This is not enough; and it becomes our duty to declare the act assailed to be unconstitutional as in contravention of the due process clause of the Fourteenth Amendment."

Another applicable decision is *Weaver* v. *Palmer Bros. Co.*, 270 U. S. 402 (1926), in which the Court rejected as void a State statute prohibiting the use of shoddy in quilts, basing its decision upon evidence (similar in nature to the constitutional evidence proffered in this case) showing that any danger from the use of shoddy could be eliminated by sterilization and upon the ground that less restrictive regulation would be adequate to secure the statutory health objectives. In reaching its decision, the Court relied in part upon regulatory provisions requiring sterilization of bedding materials contained *in other sections of the particular statute in question.* The Court said (pp. 414-415):

" . . . Here, it is established that sterilization eliminates the dangers, if any, from the use of shoddy. As against that fact, the provision in question cannot be sustained as a measure to protect health. . . .

"Nor can such prohibition be sustained as a measure to prevent deception. In order to ascertain whether the materials used and the finished articles conform to its requirements, the Act expressly provides for inspection of the places where such articles are made, sold or kept for sale. Every article of bedding is required to bear a tag showing the materials used for filling and giving the names and addresses of makers and vendors, and bearing the word 'secondhand' where there has been prior use, and giving the number of the permit for sterilizing and disinfecting where secondhand materials or feathers are used for filling. *Obviously, these regulations or others that are adequate may be effectively applied to shoddy-filled articles.*

"The constitutional guaranties may not be made to yield to mere convenience. . . . The business here involved is legitimate and useful; and, while it is subject to all reasonable regulation, the absolute prohibition of the use of shoddy in the manufacture of comfortables is purely arbitrary and violates the due process clause of the Fourteenth Amendment. . . ."

So, too, in the instant case, in view of the comprehensive regulatory provisions in other sections of the Act and in other applicable statutes, the "death sentence" provisions of Section 11(b)(1) do not constitute a reasonable regulation of interstate commerce but rather an arbitrary effort, under the guise of regulating interstate commerce, to bring about the desired social and economic objectives.

III

The Commission should have admitted evidence offered by Petitioners to establish that the provisions of Section 11(b)(1) are arbitrary and unreasonable, and therefore unconstitutional, in that they have no real or substantial relation to the purposes of the Act

Having raised the constitutional issues from the outset (R. 191, 216-218), Petitioners notified the Commission, by answer (R. 241-242) to an interlocutory show-cause order (R. 239, 247), that they intended to offer evidence to establish factually that none of the provisions of Section 11(b)(1) has any relationship to any of the statutory purposes,—particularly in light of the facts at the present time with respect to public regulation of holding companies and their subsidiaries. In a preliminary hearing, the Commission ruled that such evidence was not admissible on the ground that it was without authority to pass upon the constitutionality of the Act (R. 243, 248-252, 289). The Commission further stated that any proffer of such evidence would be premature until after a divestment order had been entered in the proceeding so that Petitioners would be able to state "in what respects they claim that the Act, as applied to them, violates constitutional immunities" (R. 250).

Thereafter Petitioners made a formal offer of most of the evidence in question, in the form of questions and answers, which was rejected by the Examiner. The proffered evidence was, however, marked for identification (R. 893) and is printed in full in the record (R. 895-1140).

The court below sustained the Commission's action (R. 1232-1234), holding that administrative boards are without

power to deal with constitutional issues except to the extent of determining their jurisdiction. That court, however, added (R. 1234):

> "It does not follow that the petitioner is deprived of the well established right to test the constitutionality of the statute by showing that it is completely lacking in factual basis. We hold merely that the proffered evidence was not admissible at the hearing before the Commission, without prejudice to the right of the petitioner to raise the same question hereafter in such other manner as it may be advised."

The court below did not indicate *when, where or how* Petitioners might exercise their "well established right" to show that the act is "completely lacking in factual basis."

Petitioners contend that the Commission's refusal to receive this evidence was not only prejudicial error but a violation of their rights under the Fifth Amendment which in and of itself requires that the proceedings be remanded.

A. Analysis of the Proffered Evidence

An analysis of Section 11(b)(1) shows that its impact extends only in *three* directions, *i.e.*, the *character of control* over operating utilities, (2) the *size* of operating utilities and holding company systems, and (3) the *relative geographic location* of the utilities which any one holding company may continue to control. That is, the divestment provisions of Section 11(b)(1) are not applicable to any utility properties or systems unless there is present holding company control, and then only (a) if the holding company system, or the operating utilities in such system, exceed certain size limitations, and (b) the relative geo-

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graphic location of the operating units in the system does not meet the specified requirements.[14]

An analysis of the Act shows that all the purposes therein, as expressed in Section 1 or elsewhere, relate to the following six factors: (1) the cost of electricity or gas to consumers; (2) economy of management and operation of operating companies; (3) economy of raising capital; (4) protection of investors; (5) effectiveness of regulation; and (6) adequacy and efficiency of service.

Being convinced, on the face of the statute, that none of the remedial devices of Section 11(b)(1) bore any real relationship to any of the basic statutory objectives, Petitioners set out to prove this factually. To this end, they authorized a leading authority in the field, Dr. M. H. Waterman, Associate Professor of Finance in the School of Business Administration of the University of Michigan, to undertake a survey to determine the validity of Petitioners' thesis.[15] Such a survey was made by Dr. Waterman and his assistants and the results thereof presented in a series of economic and statistical studies, charts and tabulations (R. 895-1140). These wholly objective studies (R. 905), which represented many months'

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[14] As pointed out by Dr. Waterman (R. 903), the impact of Section 11(b)(1) upon the *size* and *relative geographic location* of operating utilities is subsidiary to its impact on the *character of control* thereof, because Section 11 has no operative effect at all, regardless of the size or relative geographic location of utility properties, unless they are controlled by a holding company.

[15] Dr. Waterman described his assignment, in part, as follows (R. 904):

> "* * * I was asked to undertake a study to determine whether there is any evidence that the suggested economic disadvantages or evils are really a function of the fact, or have any real relation to the fact, that a utility is controlled by a holding company, or that a utility or a holding company system reaches a large size, or that utility units in a holding company system are not situated geographically with respect to each other in the manner required by Section 11."

labor on the part of Dr. Waterman and his associates (R. 905-906), were prepared in large part from recently published (and, until then, unavailable) material in the files of the Commission and the Federal Power Commission (R. 919-920).

An analysis of the proffered evidence, which was prepared on factual data and statistics covering over 95% of the entire utility industry of the nation during 1939 and 1940 (R. 916-917), with record references, is set forth as Appendix A hereto, *infra*. In essence, this evidence establishes that neither the fact that an operating utility, gas or electric, is controlled by a holding company, nor the distance of an operating utility from the main office of its parent company, nor the size, nor the increase in size, of an utility operating system or a holding company system, has any relationship whatsoever, let alone a substantial relationship, to any of the six basic objectives of the act.[16]

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[16] For example, the proffered evidence establishes, with respect to the cost of electricity to consumers, that consumers served by subsidiaries of registered holding companies in the great majority of cases pay substantially less and in no instance pay significantly more for their service than do consumers served by "independent" companies; that large operating companies serve consumers at lower rates than smaller operating companies and that there is no tendency for the cost of electricity to increase as the size of the operating utility increases or as the size of the holding company system increases, or as the distance of the operating utility from the main office of its parent increases; and that there is no discernible relationship between the cost of electricity to consumers and the relative geographic locations within a holding company system of the operating units thereof (R. 941-942, 1042, 1081, 1103).

Substantially the same facts appear with respect to economy of management, economy in raising capital, the protection of investors, adequacy of service and effectiveness of regulation (see Appendix A, *infra*).

If this evidence had been received, Petitioners submit that the Commission would have been required to find, in the entire absence of any contradictory evidence, that the provisions of Section 11(b)(1) have no relationship whatever to any purpose sought to be accomplished by the Act. But for present purposes it is not necessary to go so far. It is at least certain that the proffered evidence meets the test stated in *Pittsburgh Glass Co.* v. *Board*, 313 U. S. 146, 163 (1941), since clearly it "could have materially affected the outcome",—a fact which was assumed by the court below.

Finally, it may be pointed out that since the proffered evidence involves a study, analysis, comparison and correlation of multitudinous economic facts, statistics and data relating to the utility industry throughout the entire nation, it is not within the limits of judicial notice.[17] See

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[17] Dr. Waterman's carefully prepared and comprehensive studies are, so far as we know, the only factual data, based upon actual utility statistics, dealing with the precise issue in question.

In its brief in the court below the Commission described the proffered evidence as purporting "to show that the evils found by Congress to exist and recited in Section 1 of the Act do not in fact exist * * *"; and, referring to the voluminous Federal Trade Commission Reports and the so-called Splawn Report recited in Section 1(b) of the Act, stated that

> "Against this vast array of fact-sources, petitioners now seek to introduce the conclusions of a solitary professor of business administration, employed by petitioners to conduct a survey."

These comments are not only misleading but miss the point of Petitioners' contentions. The proffered evidence does not attempt to establish "that the evils * * * recited in Section 1 of the Act do not in fact exist." On the contrary, assuming the existence of such evils, its deals only with the specific question of the fitness of the prohibitory devices in Section 11(b)(1) to achieve the statutory purposes. The voluminous reports referred to in Section 1(b) of the Act *may be searched in vain for any facts or findings bearing on this precise issue.* There is thus no clash whatever between the proffered evidence and the factual data before Congress.

Polk Company v. *Glover*, 305 U. S. 5, 10 (1938); *Borden's Co.* v. *Baldwin*, 293 U. S. 194, 210 (1934).

B. The Proffered Evidence Was Clearly Admissible and its Rejection Was Reversible Error

It is scarcely necessary to cite authorities for the proposition that when State or Federal legislation is challenged on the ground that it has no reasonable relationship to the achievement of a proper legislative purpose, evidence bearing on such issue is not only admissible but, in most cases, a necessity.[18] Indeed, this Court has often

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[18] For cases in which economic and statistical evidence of the character in question was relied on as demonstrating the unconstitutionality of Federal or State legislation, see *Retirement Board* v. *Alton R. Co.*, 295 U. S. 330 (1935); *Lochner* v. *New York*, 198 U. S. 45, 59 (1905); *Weaver* v. *Palmer Bros. Co.*, 270 U. S. 402, 411-412 (1926). For cases in which economic data bearing on constitutional issues under the due process clauses was considered by the Court, see *Adkins* v. *Children's Hospital*, 261 U. S. 525 (1923); *Morehead* v. *N. Y. ex rel. Tipaldo*, 298 U. S. 587 (1936); *West Coast Hotel Co.* v *Parrish*, 300 U. S. 379 (1937); *Carter* v. *Carter Coal Co.*, 298 U. S. 238 (1936); *Steward Machine Co.* v. *Davis*, 301 U. S. 548 (1937); *Carmichael* v. *Southern Coal Co.*, 301 U. S. 495 (1937); *Helvering* v. *Davis*, 301 U. S. 619 (1937); *Virginian Ry.* v. *Federation*, 300 U. S. 515 (1937). For like cases under the commerce clause, see *Labor Board* v. *Jones & Laughlin*, 301 U. S. 1 (1937); *Santa Cruz Co.* v. *Labor Board*, 303 U. S. 453, 468 (1938); *Edison Co.* v. *Labor Board*, 305 U. S. 197, 231 (1938); *Labor Board* v. *Fainblatt*, 306 U. S. 601, 607 (1939).

Generally, see: Note, *"The Presentation of Facts Underlying the Constitutionality of Statutes"*, 49 Harv. L. Rev. 631 (1936); Note, *"The Presumption of Constitutionality Reconsidered"*, 36 Col. L. Rev. 283 (1936); *Ziskind, "The Use of Economic Data in Labor Cases"*, 6 Chicago L. Rev. 601, 649, 650 (1939); *Bikle, "Questions of Fact Affecting Constitutionality,"* 38 Harv. L. Rev. 6, 12 (1924); *Dickinson, "Crowell & Benson: Judicial Review of 'Constitutional Fact'"*, 80 Pa. L. Rev., 1055, 1068, 1072 (1932). See also, *Rottschaeffer, Constitutional Law* (Ed. 1939), pp. 458-460; and Pike & Fischer, Administrative Law, Current Text, Sec. 45a.22 (1941), *Introduction Before Agencies of Evidence Bearing on Constitutional Issues*, relating specifically to the case at bar.

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remanded cases involving such issues to lower tribunals for inclusion of such evidence in the record. See *Polk Company* v. *Glover, supra; Borden's Co.* v. *Baldwin, supra; Hammond* v. *Schappi Bus Line,* 275 U. S. 164 (1927); *Chastleton Corp.* v. *Sinclair,* 264 U. S. 543, 548 (1924); *Cf. Carolene Products Co.* v. *U. S.,* 323 U. S. 18, 31 (1944).

The applicable rule is well stated in *U. S.* v. *Carolene Products Co.,* 304 U. S. 144 (1938), where the Court, in dealing with the validity of challenged Federal legislation, said (pp. 152-153):

> "We may assume for present purposes that no pronouncement of a legislature can forestall attack upon the constitutionality of the prohibition which it enacts by applying opprobrious epithets to the prohibited act, and that a *statute would deny due process which precluded the disproof in judicial proceedings of all facts which would show or tend to show that a statute depriving the suitor of life, liberty or property had a rational basis.*
>
> • • • • • •
>
> "Where the existence of a rational basis for legislation whose constitutionality is attacked depends upon facts beyond the sphere of judicial notice, such facts may properly be made the subject of judicial inquiry. . . ."

To the same effect is *Borden's Co.* v. *Baldwin,* 293 U. S. 194 (1934), *supra,* in which the Court said (p. 210):

> "• • • But where the legislative action is suitably challenged, and a rational basis for it is predicated upon the particular economic facts of a given trade or industry, which are outside the sphere of judicial notice, *these facts are properly the subject of evidence and of findings.* With the notable expansion of the scope of governmental regulation, and the con-

> sequent assertion of violation of constitutional rights, it is increasingly important that when it becomes necessary for the Court to deal with the facts relating to particular commercial or industrial conditions, they should be presented concretely with appropriate determinations upon evidence, so that conclusions shall not be reached without adequate factual support."

Although the court below recognized Petitioners' "well established right", at some other unspecified time and place, to prove that the Act is "lacking in factual basis" (R. 1231), it held that the proffered evidence was not admissible before the Commission on the ground that an administrative tribunal is without authority to deal with constitutional issues and must assume the validity of the statute under which it operates. As shown later, the court's conclusion does not follow from its premise; but the premise is ill-founded.

Inherent in the functioning of any administrative tribunal is a preliminary determination of its jurisdiction in the premises. Accordingly, when any proposed action of such a tribunal is met by the contention that the statutory provision upon which it bases its authority is invalid, it must necessarily determine whether such claim is ill- or well-founded. In no other way can its members live up to their respective oaths "to support and defend the Constitution of the United States". (See, R. S., §§1756-1757; 14 U. S. C. §16.)

This conclusion is confirmed by Section 11(b)(1) which provides that no order may be issued thereunder except "after . . . hearing". The "hearing" which is thus made a condition precedent to administrative action must provide for the introduction of evidence with respect to *all* issues; and a refusal to receive and consider evidence which is

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relevant and material to the issue to be determined is itself a violation of due process. See *New England Divisions Case*, 261 U. S. 184, 200 (1923); *R. R. Comm'n* v. *Pacific Gas Co.*, 302 U. S. 388, 393 (1935); *Morgan* v. *United States*, 298 U. S. 468, 480 (1936); *Ohio Bell Tel. Co.* v. *Comm'n*, 301 U. S. 292, 304-305 (1937); *Jefferson Electric Co.* v. *National Labor Relations Bd.*, 102 F. (2d) 949, 954 (C. C. A. 7th, 1939).

While, concededly, there is little discussion in the cases as to the authority of administrative agencies to determine constitutional issues, the absence of such discussion—until very recent days, at least—seems to have resulted from a general acceptance of the fact that such authority exists. Thus, in *E. I. Dupont De Nemours & Co.* v. *Boland*, 85 F. (2d) 12 (C. C. A. 2d, 1936), which involved a suit to restrain the members of the National Labor Relations Board from proceeding under the National Labor Relations Act on the ground that that statute was unconstitutional, the court held that there was no basis for equity jurisdiction since the plaintiff could assert its constitutional objections in any proceeding brought against it by the Board. To the same effect is *Precision Castings Co.* v. *Boland*, 13 F. Supp. 877 (W. D. N. Y., 1936), affirmed 85 F. (2d) 15 (C. C. A. 2d, 1936), where the court said (p. 885):

> ". . . Plaintiff has an adequate remedy at law in its right to raise the constitutional issue *before the Board* and, ultimately, before the courts."

See also *Lawrence* v. *St. L.-S. F. Ry.*, 274 U. S. 588, 592-593 (1927); *Manufacturers Ry. Co.* v. *United States*, 246 U. S. 457, 488 (1917).

Support for the above conclusion is found in the well established practice of the Board of Tax Appeals (before it became the Tax Court), one of the oldest of the administrative tribunals (*Old Colony Tr. Co.* v. *Comm'r Int. Rev.*, 279

U. S. 716, 725 (1929)), to pass upon the constitutionality of statutes in proceedings before the Board. See, *Independent Life Insurance Co. of America*, 17 B. T. A. 757, 765 (1929); *American Security & Trust Co., et al., Executors*, 24 B. T. A. 334, 341 (1931); *Lord Forres*, 25 B. T. A. 154 (1932); *Rita O'Shaughnessy, Executrix*, 21 B. T. A. 1046 (1930).

In upholding the Commission's action the court below relied largely upon its own decision in *Panitz* v. *District of Columbia*, 112 F. (2d) 39 (Ct. of App. D. C., 1940), but the only point actually decided in that case was that the doctrine of exhaustion of administrative remedies does not *require* a challenge of the constitutionality of the tax before the assessor as a condition precedent to an action in a district court attacking the statute as unconstitutional.

But whether or not the Commission is authorized or required to pass on the constitutional issues, it should have received the proffered evidence, and made findings with respect thereto, since this is the only feasible way in which Petitioners may exercise their undoubted right to challenge the validity of the Act.

By Section 24(a) of the Act, any party aggrieved by an order entered under Section 11(b)(1) is given the right to appeal to a circuit court of appeals, and the method of such review is specified. After service and filing of a petition for review, the Commission is required to certify and file in the circuit court of appeals "a transcript of the record upon which the order complained of was entered." Upon such review, "the findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive". Section 24 further provides for an application to the court for leave to adduce additional evidence, which application may be granted if "it is shown to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to ad-

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duce such evidence in the proceedings before the Commission." The statute does not provide, however, for the taking of this evidence by or before the court, but specifies that "the court may order such additional evidence to be taken *before the Commission*. . . ." It is thus apparent that the only way that evidence can come before a Circuit Court of Appeals, on an application to review an order of the Commission under Section 11(b)(1), *is by inclusion of such evidence on the record of the Commission "upon which the order complained of was entered"*. The structure of the Act thus clearly indicates that *all* relevant evidence should be presented to and received by the Commission. (*Cf. Marshall Field & Co.* v. *Board*, 318 U. S. 253 (1943); and see also, *Colorado-Wyoming Co.* v. *Comm'n*, 324 U. S. 626, 634 (1945), in which the Court pointed out, in connection with a statutory provision closely similar to Section 24(a) of the Act, that "we must first know what the 'finding' is before we can give it that conclusive weight".)

Furthermore, Section 24 provides that upon review of an order under Section 11(b)(1) "no objection to the order of the Commission shall be considered by the Court *unless such objection shall have been urged before the Commission* or unless there were reasonable grounds for failure so to do." It has been expressly held that this provision prohibits review of *constitutional issues* which were not raised before the Commission. *Pacific Gas & Elec. Co.* v. *Securities & Exchange Com'n.*, 127 F. (2d) 378, 386 (C. C. A. 9th, 1942), aff'd on rehearing, 139 F. (2d) 298, aff'd No. 55, October Term, 1944, March 12, 1945; *Todd* v. *Securities and Exchange Commission*, 137 F. (2d) 475, 478 (C. C. A. 6th, 1943). And see, *Marshall Field & Co.* v. *Board*, 318 U. S. 253, 256 (1943), *supra*. The only way Petitioners could have effectively "urged" the particular objection here involved was by

doing what it was precluded from doing, i.e., offering to prove affirmatively that Section 11(b)(1) has no rational basis.

Apart from the specific provisions of Section 24, it is logical and desirable, because of the weight attributed to the factual findings of administrative tribunals, that evidence bearing upon constitutional issues should be presented to and passed upon by the particular administrative tribunal in question in the same manner as other evidence. Although the precise point has not been passed upon by this Court, it was indicated in *Manufacturers Ry. Co.* v. *United States*, 246 U. S. 457 (1917), that constitutional evidence should, in the first instance, be presented to the particular administrative tribunal involved. In that case this Court stated (p. 489) that even though a constitutional determination by an administrative agency is not conclusive, "Nevertheless, correct practice requires that, in ordinary cases, and where the opportunity is open, all the pertinent evidence shall be submitted in the first instance to the Commission." See also *Lawrence* v. *St. L.-S. F. Ry.*, 274 U. S. 588, 592, 593 (1927); *Labor Board* v. *Jones & Laughlin*, 301 U. S. 1, 47 (1937). It is to be noted that evidence of the type which Petitioners desire to offer has in many instances been received by the National Labor Relations Board,—the practice and procedure under the National Labor Relations Act both before the Board and upon review of its orders being closely similar to those under the Act here involved. *National Labor Relations Board* v. *Associated Press*, 85 F. (2d) 56, 57, 61 (C. C. A. 2d, 1936). *Cf. Labor Board* v. *Jones & Laughlin*, 301 U. S. 1 (1937); *Washington Coach Co.* v. *Labor Bd.*, 301 U. S. 142 (1937); *Labor Board* v. *Clothing Co.*, 301 U. S. 58 (1937).

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Petitioners' contentions are strongly supported by practical considerations. Concededly, they have a "well established" right to show, in *some* proceeding, that the Act is "lacking in factual basis" (R. 1234); and the only practicable course is to present the evidence to the Commission. Conceivably, it might be possible for Petitioners, when after years of litigation the challenged order has become final, to introduce the evidence in question in an enforcement proceeding brought against them by the Commission in a district court under Section 11(d) of the Act or in an independent proceeding brought by them in a district court to enjoin enforcement of the order. But in either such event Petitioners would have no opportunity to be effectively heard on the question of the reasonableness of the legislation until all other issues, *including all other constitutional issues,* had first been passed upon by the Commission, the Circuit Court of Appeals and this Court (not only once but possibly twice, since in the case at bar the Commission's order was *reversed,* so that a further hearing before the Commission may be required quite apart from this particular point). Elementary considerations of fairness and practical considerations in respect of judicial review of administrative action require that no litigant should be subjected to such a piecemeal, prolonged, and illogical adjudication of a clearly established constitutional right.

In *Labor Board* v. *Jones & Laughlin,* 301 U. S. 1 (1937), *supra,* the Court, referring to a review of orders of the National Labor Relations Board by a circuit court of appeals, stated (p. 47) that:

> ". . . Upon that review all questions of the jurisdiction of the Board and the regularity of its proceedings, *all questions of constitutional right or statutory authority,* are open to examination by the court . . ."

In all essential procedural features involving appellate review the National Labor Relations Act and the Act here involved are identical. If, in the case at bar, "all questions of constitutional right" are to be open upon review, this proceeding must be remanded to the Commission for receipt of the proffered evidence so that it may become a part of the record and its effect determined in the method provided by the Act.

IV

The Commission's orders are illegal in so far as they purport to control Engineers' choice of its single system [19]

Under Section 11(b)(1), as stated above, it is the Commission's duty to require each registered holding company to limit its operations "to a single integrated public-utility system, and to such other businesses as are reasonably incidental or economically necessary or appropriate to the operations of such public-utility system"; and to such additional integrated public-utility systems as meet the A, B and C standards.

In the case at bar, the Commission found, in a preliminary hearing, that each of the Virginia and Gulf States electric systems constituted an "integrated public-utility system", as defined in Section 2(a)(29) of the Act, and that *either* of such systems might appropriately be retained by Engineers as its "single" system (R. 256), but that, under the Commission's "one-area" interpretation of clause (B), Engineers could not retain *both* (R. 275-276). Thereafter, at Petitioners' request and so that Engineers

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[19] As shown later, this issue was in the main decided by the court below in favor of Petitioners.

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might make an intelligent choice as between the Virginia and Gulf States systems, the Commission made so-called advisory findings as to what additional systems and businesses might be retained by Engineers, first, with Virginia as the single system and, in the alternative, with Gulf States as the single system (R. 81 *et seq.*). Then, in its order of September 16, 1942, the Commission, instead of permitting Engineers to choose as between the two systems, directed that Engineers divest itself of all its properties other than Virginia unless within 15 days from the entry of the order, Engineers should file with the Commission a petition to retain Gulf States, instead of Virginia, as its single system and *the Commission should grant such petition* (R. 161). Since any choice by Engineers was to be subject to approval by the Commission, the necessary effect of the order was (a) to deny Engineers the right to choose as between the two systems and (b) to place the power to make the choice in the Commission itself.[20]

Thereafter, Petitioners filed a petition for rehearing and for leave to adduce additional evidence in which they objected to the order, *inter alia*, in so far as it specified the single system to be retained by Engineers (R. 299-300). By its order of October 6, 1942, the Commission denied said petition but modified its prior order so as to give Engineers an additional 15 days in which to petition for leave to re-

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[20] The order provided as follows (R. 161):

"IT IS FURTHER ORDERED that notwithstanding the provisions of Rule XII(d) of the Commission's Rules of Practice Engineers Public Service Company may, within fifteen days of the date hereof, petition for leave to retain as its principal system the electric utility system of Gulf States Utilities Company;

Provided, however, that the Commission reserves the right to grant, deny, or dispose of any such petition according to the merits of the grounds urged in support thereof, and to take such other action with respect thereto as may appear to the Commission to be appropriate."

tain Gulf States as its single system (R. 163-165). No such petition was filed by Engineers.

In the court below, Petitioners contended that the Act leaves to the holding company which owns more than one "integrated public-utility system" the choice of its single system, and that the Commission has no authority under the Act or otherwise to control Engineers' choice as between Virginia and Gulf States. In the main, this contention was upheld by the court below, which stated (R. 1230-1231):

> "The statute is silent on the point. . . . *No standards governing the choice of a principal system are set up in the Act.*
>
> "It is a reasonable interpretation that the holding company rather than the Commission has the right of choice, since the holding company is the lawful owner of the combined properties and the public interests are protected by the grant of power to the Commission to determine what integrated public-utility systems are involved in a given case and what additional systems and additional businesses may be retained therewith under the terms of the statute. The statutory purposes are not impeded by this interpretation and the contention is avoided that the delegation of arbitrary power to the Commission to select the principal system without Congressional standards to guide it would be unconstitutional."

The above ruling is clearly sound. The court went on, however, to add (R. 1232) that "if the holding company does not make its selection in a reasonable time the Commission may designate the principal system." The latter statement is challenged by Petitioners on the ground that it is inconsistent with the above quoted statements of the court, and on the further ground referred to in sub-point B, p. 90, *infra*.

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A. The Act Does Not Authorize the Commission to Select a Holding Company's Single System and Contains No Legislative Standards Governing Any Such Selection

Neither Section 11 nor any provision of the Act purports to confer upon the Commission authority to select one of two or more integrated public-utility systems which may be retained by a holding company as its single system; and if the Act granted any such authority it would be void as an unlawful delegation of legislative power in violation of Section 1 of Article I of the Constitution since there is a complete absence of any legislative standards to guide the Commission in making such selection. *Cf. Panama Refining Co.* v. *Ryan,* 293 U. S. 388 (1935); *Schechter Corp.* v. *United States,* 295 U. S. 495 (1935).

That the Act contains no such legislative standards is apparent upon examination of Section 11(b)(1). That Section limits the operations of a holding-company system in three distinct respects:

(1) to a single integrated public-utility system;

(2) to such "other businesses", *i.e.,* other than a public-utility as such, as are "reasonably incidental, etc."; and

(3) to one or more additional integrated public-utility systems if they meet the ABC standards.

As to (2) above, *i.e.,* the limitation of "other businesses", the legislative standards are set forth in the second "other business" clause of Section 11, which permits the retention of those businesses which the Commission "shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems."

As to (3) above, *i.e.*, the additional systems which may be retained with the single system, the legislative standards are stated in clauses (A), (B) and (C), which set forth, respectively, an economic standard, a geographical standard, and a size standard.

As to (1) above, *i.e.*, the limitation of operations to a "single integrated public-utility system", *there are no standards whatsoever.* There is, of course, in Section 2(a)(29), a definition of an "integrated public-utility system" but there is nothing in Section 11 or elsewhere to serve as a guide to the Commission in choosing *which* integrated system shall be selected as the single system in a case where, as here, there are admittedly two or more such integrated systems.

All the Act provides in this connection is that the Commission shall take such action as it "shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system". This prescribes no standards; it merely directs a result. Congress did not say, for example, that in such a case the Commission should choose as the single system that which is the most important operating system or the one with the greatest revenues; or that the most appropriate single system should be chosen from the point of view of the public interest or for the protection of investors or consumers,—standards which Congress did apply to other limitations imposed by Section 11(b)(1). There is nothing whatever to fetter the uncontrolled discretion of the Commission in choosing (if it has the power to choose) one as between several integrated systems.

Despite the fact that Congress granted the Commission no power to choose for a holding company as between several eligible systems, the Commission by its order of Sep-

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tember 16, 1942, provided that if a petition were filed by Engineers seeking to choose Gulf States as its single system instead of Virginia, the Commission "reserves the right to grant, deny, or dispose of any such petition according *to the merits* of the grounds urged in support thereof ....." (R. 161). If the Act contained any standards governing the granting or denial of any such petition, no doubt the order would have provided that the decision would be made according to such standards. There being none, however, the Commission attempted to legislate by giving itself power to decide "according to the merits",—a phrase so vague as to be insufficient as a standard even if it had been used in the Act.

Since there are no legislative standards to govern the Commission's action in choosing for a holding company as between two or more eligible systems, the Court cannot imply any authority to make such choice because to do so would render the Act unconstitutional. See *Labor Board* v. *Jones & Laughlin*, 301 U. S. 1, 30 (1937).[21]

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[21] A contrary result was reached in *North American Co.* v. *Securities and Exchange Com'n*, 133 F. (2d) 148, 151 (C. C. A. 2d, 1943), No. 1, present Term, where the court upheld the Commission's authority to select the holding company's principal system, after the holding company had refused to express a preference, on the sole ground that it was the Commission's duty to act under Section 11(b) "as soon as practicable". But, clearly, a legislative command to act as of any given time does not constitute a legislative standard governing the question *whether* action shall be taken, and, if so, under what conditions. Moreover, in the *North American Company* case, the constitutional point as to the delegation of legislative power was not raised, and attention of the court was not called to the fact that there are no legislative standards whatever governing the choice by the Commission of a single system as among several eligible systems.

B. If Engineers May Lawfully Be Compelled to Limit Its Operations to Only One of Its Two Chief Integrated Systems, the Only Form of Order Which the Commission May Properly Enter Is an Alternative Order Requiring Engineers to Dispose of Either Virginia or Gulf States Within the Statutory Period

Although upholding Petitioners' contention that "the holding company rather than the Commission has the right of choice", the court below went on to state that "the right must be exercised without unnecessary delay" and that "if the holding company does not make its selection in a reasonable time the Commission may designate the principal system" (R. 1232).

Petitioners disagree with the last-mentioned statements. In the absence of any legislative standards, no construction of the Act, which, under any conditions, leaves the choice of the single system with the Commission, is permissible without rendering the Act unconstitutional; and this conclusion follows regardless of whether the holding company acts diligently or otherwise. Surely, mere delay by the holding company in making its choice could not confer on the Commission an unconstitutional power.

This is easily demonstrated. Suppose, as the court below suggests, the Commission should enter an order requiring Engineers to make its choice between Virginia and Gulf States within a six months' period, on the theory that such period was a "reasonable time"; and suppose further that Engineers did not make such choice on the ground that the time allowed was not reasonable. If the Commission itself should then make the choice, as the court below suggests, it would be construing the Act as granting it the power so to do. But there would still be no standards in the Act to guide it in making that choice, and the absence of such

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standards would make the Act, as so construed, unconstitutional as an unlawful delegation of legislative power.

This conclusion does not interfere with the proper accomplishment of the statutory objectives. The problem is readily met by an alternative order directing Engineers to dispose of either Virginia or Gulf States within the time specified in the Act for the divestment of properties, thus leaving solely to Engineers the choice as between the two systems. Since the Commission has already determined, as to both Virginia and Gulf States, the additional systems and businesses which could be retained, no possible delay can be occasioned by this procedure.

But whether or not, upon the assumptions stated, an alternative order is the only proper form of order, the choice of the single system, under any tenable construction of the Act, belongs solely to Engineers, and since the orders here in question reserve to the Commission the power to choose the single system which Engineers shall continue to hold, they are clearly illegal and the action of the court below in setting them aside should be affirmed.

V

The Commission and the Court below erroneously construed clause (B) of Section 11(b)(1) as requiring that all systems, including the single system, be located in one geographical area

The requirement of Section 11(b)(1) that the Commission limit each holding company to a "single integrated public-utility system" is subject to the proviso (see p. 17, *supra*) that the Commission "*shall* permit" the retention of "one or more *additional* integrated public-utility systems" if it finds that such additional systems comply with

clauses (A), (B) and (C) of said proviso, said clauses being commonly known as the A B C standards. The A standard has to do with economies of operation, the B standard with geographical location, and the C standard with size. Clause (B) provides only that "All such additional systems" must be "located in one State, or in adjoining States, or in a contiguous foreign country".

The proper interpretation of clause (B) is of obvious importance to Petitioners because, as shown above (p. 6, *supra*), Engineers has, among others, a system in Virginia, West Virginia and North Carolina (Virginia), a system in East Texas and Louisiana (Gulf States), and a system in West Texas and New Mexico (El Paso (Texas)),—all three of which are important electric operating systems.

Since clause (B) relates only to the geographical inter-relationship of the *additional* systems, Petitioners contended before the Commission[22] that Engineers clearly had the right, with Virginia as its single system, to retain also Gulf States and El Paso (Texas)—both located in Texas and States adjoining Texas—as "additional" systems, provided it appeared that Gulf States and El Paso (Texas) met the A and C standards (R. 258). The Commission, however, interpreted clause (B) as defining not only the geographical inter-relationship of additional systems but also the geographical relationship of such additional systems to the single system; and construed the clause *as if it read* as follows (R. 260):

> "(B) All of such additional systems are located in a State *in which the single integrated public-utility system operates,* or in States adjoining such

[22] This contention was made at a preliminary hearing, prior to the submission of any testimony, called for the purpose, among others, of simplifying the issues (R. 237, 238-242, 243-297).

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a State, or in a foreign country contiguous thereto" (italics in original).[23]

Under the Commission's interpretation, which it referred to as the "one area" interpretation in contrast with the so-called "two area" interpretation urged by Petitioners (R. 258-276), Engineers was prevented from retaining, with Virginia as its single system, either Gulf States or El Paso (Texas); and on the strength of such interpretation the Commission precluded Engineers from introducing testimony to show that both Gulf States and El Paso (Texas) are retainable by Engineers, under the A and C standards, as systems additional to Virginia.

Petitioners contend that the Commission's interpretation of clause (B), which was adopted by the court below with hesitancy (R. 1215), is plainly wrong.

A. The Language of Clause (B) Is Clear and Unambiguous, and Unmistakably Permits Retention of Properties in Two Geographical Areas

That portion of Section 11(b)(1) preceding the proviso containing the (A), (B) and (C) clauses deals with a "single integrated public-utility system"; and by definition [Section 2(a)(29)] an "integrated public-utility system" must be confined in its operations "to a single area or region, in one or more States".

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[23] As more completely expressed by the Commission in its preliminary Opinion of July 23, 1941 (R. 269-270), its interpretation of the proviso to Section 11(b)(1) is that the Commission—

> "* * * by appropriate administrative action, shall require each registered holding company (and each of its subsidiaries) to limit the public-utility operations of its holding-company system to (a) a single integrated public-utility system and (b) such additional integrated public-utility systems as meet the standards of clauses (A) and (C) *and* are located *in a State in which such single system operates,* or in States adjoining such a State, or in a foreign country contiguous thereto."

The subject matter of the proviso itself is "one or more *additional* integrated public-utility systems"; and the proviso directs the Commission to permit retention of any such additional systems if it finds that they meet the economy test of (A), the geographical test of (B), and the size test of (C). Clause (B) provides as follows:

> "(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country;"

The (A), (B) and (C) clauses present a clear and complete scheme for determining what additional systems may be retained; and in unambiguous language permit the retention of additional systems provided only that the A and C standards are met and that "All of such additional systems" are in one geographical area. By thus providing in express terms that a holding company may retain, with its "single integrated public-utility system", "additional systems" which meet the A and C standards and are located in a single geographical area, and by failing to require any geographical relationship between the single system and the additional systems, the Act clearly permits the retention of properties in at least two geographical areas.

In order to give clause (B), which relates solely to the location of "All such additional systems", the Commission's restrictive one-area interpretation, either the word "additional" must be stricken out, or, as the Commission itself suggests (R. 260), there must be interpolated after the word "State" the words "in which the single integrated public-utility system operates".

It may be doubted whether it is ever permissible for a court to alter the plain meaning of a statute for the purpose of accomplishing a supposed contrary intent (see

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Helvering v. *City Bank Co.*, 296 U. S. 85, 89 (1935)), especially when the statute is obviously the work of a skilled draftsman, is highly penal in character, and is in derogation of common right (see *Texas & Pac. Ry.* v. *Abilene Cotton Oil Co.*, 204 U. S. 426, 437 (1907)). In any event, however, words may not be added to or deleted from a statutory provision under the guise of interpretation unless such action is *unmistakably* required by its context or its legislative history. See *McDonald* v. *Thompson*, 305 U. S. 263, 266 (1938); *Ginsberg & Sons* v. *Popkin*, 285 U. S. 204, 208 (1932). In the case of clause (B), there is nothing either in its context or its legislative history which justifies distortion of its plain language.

In support of its one-area interpretation, the Commission suggests (R. 259) that the "primary purpose" of Section 11(b)(1) was to restrict the operation of each holding-company system to a "*single* integrated public-utility system"; that it is only "*as an exception to that provision* that additional integrated public-utility systems are permitted to be retained"; and that the validity of the so-called two-area interpretation must be looked upon with doubt since it results in "nullifying the primary purpose of Section 11(b)(1)". Such reasoning, in the language of an earlier day, is an attempt to pull oneself up by one's own boot strap. Obviously, the "primary purpose" of Section 11(b)(1) can be determined only by looking at it as a whole, including its proviso. To find its meaning otherwise necessarily involves a presumption as to the intent of the legislature on the basis of a part only of the statute.

There is nothing in Section 11(b)(1), or elsewhere in the Act, which is inconsistent with the plain meaning of clause (B); and both of the two most closely related clauses, i.e., (A) and (C), can be given full and complete

effect on the basis of such plain meaning. In fact, in light of the legislative history, now to be considered, there is every reason for believing that clauses (A) and (C) were clearly intended to apply only to their obvious grammatical antecedent, namely, "one or more *additional* integrated public-utility systems".

B. Nothing in the Legislative History of Section 11(b)(1) Warrants an Interpretation of Clause (B) Contrary to Its Plain Meaning

The Commission recognizes that the one-area interpretation requires a distortion of the language of clause (B), but seeks to justify such distortion on the basis of legislative history. An analysis of such legislative history, however, shows that in larger part it contradicts the one-area interpretation, and that the most which can be said for the remainder is that it is so ambiguous that it may not be resorted to for interpreting clause (B) contrary to its plain meaning.

1. The "one-area" interpretation reflects no real compromise of the sharply conflicting House and Senate views, although the legislative history shows clearly that such a compromise was intended

No approach to the legislative history of clause (B) can properly be made without starting with the basic controversy which developed early between the House and Senate as to the scope of the so-called "integration" provisions.

Under Section 11 of the Bill as passed by the Senate on June 11, 1935 (S. 2796, 74th Cong., 1st Sess.; 79 Cong. Rec. 9065), a holding company as such could continue in existence only if it were a "first degree holding company", and then only if the Federal Power Commission certified that the holding company relationship was necessary, under

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applicable law, "for the operations of a *geographically* and economically integrated public-utility system serving an economic region in a single State or extending into two or more contiguous States or into a contiguous foreign country."[24]

As thus passed by the Senate, the Bill was sent to the House which on July 2, 1935 (79 Cong. Rec. 10639-10640), substituted a much more flexible Section 11, providing only for such divestments as the Commission might find necessary to limit the operations of a holding-company system to a single integrated public-utility system, with the exception, however, that if the Commission found it was not necessary in the public interest to so limit the operations of such holding-company system, the Commission should require such company to take only such action as the Commission found necessary to limit such operation to *such number of integrated public-utility systems* as it found might be in-

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[24] Under Section 11(b)(3) of S. 2796, as passed by the Senate, the Commission was directed (R. 262, footnote 28; see S. Rept. No. 621, 74th Cong., 1st Sess., p. 32):

> "Promptly after January 1, 1940, to require each registered holding company, to take such steps (either by divesting itself of control, securities, or other assets, or by reorganization or dissolution, or otherwise) as the Commission finds necessary or appropriate to make such company cease to be a holding company: Provided, however, that the Commission, upon such terms and conditions as it may find necessary or appropriate in the public interest or for the protection of investors or consumers, shall permit a registered holding company to continue to be a holding company in the first degree if such company has obtained from the Federal Power Commission a certificate that the continuance of the holding-company relation is necessary under the applicable State or foreign law, for the operations of *a geographically and economically integrated public-utility system serving an economic region* in a single State or extending into two or more contiguous States or into a contiguous foreign country."

cluded in such holding-company system consistently with the public interest.[25]

The report of the House Committee on Interstate and Foreign Commerce accompanying S. 2796 emphasized that the House §11, in contrast to the Senate §11, permitted the retention of "such number of integrated public-utility systems" as the Commission found could be included in the holding-company system consistently with the public interest (H. Rept. No. 1318, 74th Cong., 4th Sess., pp. 6, 17). Representative Eicher submitted a minority and dissenting report on the ground that any relaxation of the single-area requirement would be a departure from the President's recommendations, and because in his opinion the House §11 sanctioned the *status quo* and proceeded on the theory that the public interest required merely the arresting of *further* concentrations of control over operating utilities (*ibid.*, pp. 44-45, 47).[26]

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[25] Section 11 of the House substitute provided (R. 262-263, footnote 29; see H. Rept. No. 1318, 74th Cong., 1st Sess., pp. 6, 17):

> "(b) It shall be the duty of the Commission after notice and opportunity for hearing, by order to require each registered holding company and each subsidiary company thereof to take such action (either by divesting itself of any interest in or control over property or persons, or otherwise) as the Commission finds necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system; except that if the Commission finds that it is not necessary in the public interest to so limit the operations of such holding-company system, the order of the Commission shall require such company to take only such action (either by divesting itself of any interest in or control over persons or property, or otherwise) as the Commission finds necessary to limit such operations *to such number of integrated public-utility systems as it finds may be included in such holding-company system consistently with the public interest.*"

[26] In the Committee hearings (in the House from February 19, 1935 to April 12, 1935, and in the Senate from April 16, 1935 to April 29, 1935) the real battleground from the beginning (aside from the broad question whether the public interest required anything

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The basic divergence between the two provisions is apparent. The Senate Bill, which permitted only a "geographically • • • integrated public-utility system serving an economic region", necessarily limited the systems which a holding company might retain, at the most, to those serving a single economic region. The House substitute, on the other hand, permitted as many systems to be retained, regardless of location, as were found by the Federal Power Commission to be consistent with the public interest.

After enactment of the House substitute the Bill was referred to a conference committee. While thus pending in conference it was subject to sharp debate in both houses. The almost equal division of opinion in the Senate (in which, on June 11, 1935, the "elimination" provisions were retained only by the margin of one vote)[27] is shown by the bitter opposition of the administration leaders, on July 8, 9 and 10, to Senator Dietrich's two motions, first to substitute the House §11, and second, to instruct the Senate

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more than a regulatory measure, without any "elimination" provisions) was on the question whether there should be any limit on the *number of regional systems*. On April 4, 1935, just before the House hearings were concluded, Mr. Harriman, President of the Chamber of Commerce, for the first time proposed the two region compromise, giving in detail his reason why this amount of flexibility would aid greatly in the rearrangement of utility properties (see, Hearings before House Committee on Interstate and Foreign Commerce on H. R. 5423, 74th Cong., 1st Sess., Part 2, pp. 1558-1559). Later, Mr. Corcoran in the testimony before the Senate Committee stated his belief that the Harriman proposal was intended to apply particularly to the U. G. I. and Commonwealth and Southern systems, each of which had the bulk of their properties *in two large compact regions* (see, Hearings before Senate Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess., p. 202). The Harriman proposal was unquestionably the origin of the two-region compromise which was ultimately adopted by the Senate, with certain refinements, on August 24, 1935 (see p. 101, *infra*).

[27] On June 11, 1935, the Senate rejected the Dietrich amendments which would have almost entirely eliminated the integration provisions of Section 11, by a vote of 45 to 44 (79 Cong. Rec. 9040, 9053).

conferees not to insist on the Senate §11 (79 Cong. Rec. 10756-10757, 10838-10849, 10916-10917). The determined attitude of the House during this period is shown by the following: on July 1, 1945, Mr. Eicher's motion to substitute the Senate §11 for the House §11 was lost by 216 to 146 (79 Cong. Rec. 10509, 10555); on July 2, 1935, the House voted as Committee of the Whole to report out the House bill, including House §11, by 246 to 133 (79 Cong. Rec. 10637); also on July 2, 1935, the House adopted the House Committee Report by vote of 258 to 147 (79 Cong. Rec. 10637), and then passed the House Bill by a vote of 323 to 81 (79 Cong. Rec. 10639-10640); and on August 1, 1935, Mr. Rayburn's motion that the House conferees be instructed to agree to the Senate §11 was defeated by 209 to 155 (79 Cong. Rec. 12265, 12271).

In this stalemate Mr. Rayburn on August 22, 1935, moved in the House that the House conferees be instructed to agree to a substitute for Section 11, such substitute being in the form of Section 11 as finally enacted. *This was the first appearance of Section 11 in its present form.* In presenting his motion, Mr. Rayburn stated that the Senate §11 permitted no exception to the "single area" requirement; that the House §11 permitted the retention of such number of systems as the Commission might deem consistent with the public interest, and that the compromise §11, as reflected in his motion, contained an exception to the single-area requirement, but one which did not go "quite as far as the House provision because of the necessity of meeting A B C standards with respect to additional systems". Mr. Rayburn then discussed at length the A B C standards, as set forth in the compromise §11, and mentioned the "restricted areas" provision of clause (B), *but made no reference whatever to any "one-area" requirement.* (79 Cong. Rec. 14162-14165).

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Mr. Rayburn supported his motion by having the Clerk read the President's letter of August 21, 1935, to Mr. Rayburn, in which after referring to the new Section 11(b), the President said (79 Cong. Rec. 14164):

> "From the point of view of the House, this proposal certainly constitutes a most *generous concession* on the part of the Senate conferees.
>
> From my point of view, it represents a greater *recession* from the Senate bill than I should like to see made. But I understand the urgent desire of many members of both Houses to have a bill worked out at this session, and to that end I hope the House will find this proposal of the Senate conferees acceptable."

Thereafter, on August 24, 1935, the conference committee submitted its report (H. Rept. No. 1903, 74th Cong., 1st Sess.), which was later on the same day approved by both Houses (79 Cong. Rec. 14469-14473, 14626-14627).[28]

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[28] A perusal of the debates in the Senate and House on August 22, 1935, makes it very clear that the opponents of the Senate §11 would not have agreed to the substitute proposed by Mr. Rayburn if they had not understood that said substitute represented a substantial concession on the part of the advocates of the Senate §11. Thus, for example, after Mr. Rayburn had presented the substitute §11 on August 22, 1935, Congressman Mott stated as follows (79 Cong. Rec. 14170):

> "The language of this compromise on section 11 contains, of course, some face-saving words. This is natural. I have no doubt also that after this bill is passed the administration, for political purposes, will contend that there is really no great difference between section 11 as originally drawn and section 11 as it appears in this compromise proposal. For that reason I desire to call the attention of the House and of the country now to the fact that *no administration leader on the floor of the House has made any such contention in this debate.* They all have contended that the exact opposite is true, and in this I concur. *If it were not so, the compromise would have no chance whatever of adoption by the House.* The fact is that cold analysis will show that there is practically no similarity between section 11 of the Senate bill and the substitute section contained in the compromise, * * *."

It is thus clear that the fundamental conflict between the House and the Senate was on the broad question whether multi-area holding companies, with limited geographical spread, should be permitted, or whether, on the other extreme, holding company operations should be limited to a single area. As the result of a compromise of those extremes clause (B) was enacted. On its face, it calls for a two-area interpretation; and on this basis Section 11(b)(1) reflects a real compromise between the extreme House and Senate positions. The one-area interpretation, however, would make the purported compromise no compromise at all, but on the contrary a complete surrender by the House of its stubbornly held position.

The President obviously did not attribute a one-area interpretation to clause (B) since if he had done so he could not properly have referred to the substitute bill as a "most generous concession on the part of the Senate conferees". If clause (B) requires all retainable properties to be confined to a single area or region, as provided in the original Senate Bill, it was clearly not a "most generous concession".

In this connection, both the Commission and the court below omitted all reference to a most significant change in the compromise Bill which clearly shows that the compromise pertained to the *number of areas*. This was the dropping from the policy section [Section 1(c)] of S. 2796, as it stood until August 22, 1935, the day Mr. Rayburn made his motion, of the statement that it was the policy of the Act that properties should be eliminated which were "not economically and geographically related *in operations*" (see S. Rept. No. 621, 74th Cong., 1st Sess., p. 22), and the substitution in place thereof of a provision calling for the elimination of properties detrimental to the proper functioning of public-utility systems (see H. Rept. No. 1903,

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74th Cong., 1st Sess., p. 3). This change would have been wholly unnecessary if it were the real intention of clause (B) that all retainable systems should be located in one geographical area, in which case they would necessarily be so related "in operations". The obvious reason for this change in the policy clause was to make it consistent with clause (B).

2. The plain meaning of clause (B) should not be distorted on the basis of vague and ambiguous statements in the Committee Report and Debates

As stated above, the conflicting House and Senate views as to Section 11 were resolved by the adoption, by both Houses, of the substitute Section 11 first proposed by Mr. Rayburn on August 22, 1935 (79 Cong. Rec. 14162). This substitute was commented on by the Conference Committee in its Report of August 24, 1935 (H. Rept. No. 1903, 74th Cong., 1st Sess.) Said Report, after pointing out that under the Senate §11 the operations of a holding company were required to be limited to "a geographically and economically integrated public-utility system serving a limited region in a limited area" and that under the House §11 a holding company, in addition to having "one integrated public-utility system" (which was stated to have a meaning substantially the same as a "geographically and economically integrated public-utility system"), might continue to hold such *additional* integrated public-utility systems as the Commission found to be consistent "with the public interests", states as follows (*ibid.*, p. 69):

> "The substitute agreed to, with respect to the question of integrated public-utility systems, provides that the Commission shall as soon as practicable after January 1, 1938, require each holding-company system to be limited to a single integrated

> public-utility system and to such other businesses as are reasonably incidental or economically necessary or appropriate to the operation of such integrated system, but includes an exception. This exception provides that the Commission shall permit additional integrated systems, if it finds that (1) each such additional system cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by the holding company, (2) *all such additional systems are located in a restricted area,* and (3) the continued combination of such systems under the control of one holding company is not so large as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation."

This description of the compromise Section 11 accurately reflects the language of the Act itself and clearly indicates that the provisions which are now known as the A B C standards were designed to relate *only to the additional systems.* Notwithstanding this clear description, however, the Commission, in giving clause (B) a construction at variance with its plain meaning, placed reliance upon another paragraph in the Conference Report (*ibid.*, p. 71; and see R. 261-265), which refers to Section 11(b)(1) as follows:

> "The substitute [Section 11(b)(1)] . . . makes provision to meet the situation where a holding company can show a real economic need on the part of additional integrated systems for permitting the holding company to keep these additional systems under localized management with a principal integrated system. Under such circumstances the Commission is directed to permit the holding company to retain control of such additional systems, even though not physically integrated with the principal system, provided all such integrated systems are located in the same State or States, or in adjoining States or a contiguous foreign country."

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Referring to this last quoted statement, the Commission first emphasizes (R. 261) the words, "to keep these additional systems under localized management with a principal integrated system." But those words, we submit, are entirely consistent with the two-area interpretation; certainly they evidence no legislative intent clearly at variance with such interpretation. The words "localized management" as used by the Committee were unquestionably intended to paraphrase the words "*advantages of* localized management" as used in clause (C) of the compromise provision, and, accordingly, the most natural meaning of the words from the Conference Report emphasized by the Commission is that the single system and the additional systems may both be retained so long as the advantages of localized management are preserved *in respect of each system*. But taking the least favorable view of these words from Petitioners' viewpoint, they constitute an ambiguous statement which wholly fails to show a clear legislative intent at variance with the language of clause (B).

The Commission further emphasizes (R. 261, 265) that portion of the Conference Report above quoted which refers to Section 11(b)(1) as permitting the holding company "to retain control of such additional systems, even though not physically integrated with the principal system, provided all such integrated systems are located in the same State or States, or in adjoining States or a contiguous foreign country". Since, however, immediately preceding the phrase "all such integrated systems" the words "physically integrated" are used in relation to the "additional systems", Petitioners contend that fairly construed said phrase refers only to the "additional systems" and not, as the Commission infers, to the combination of the principal system and the additional system. At the worst,

the language in question is ambiguous and fails entirely to establish a clear legislative intent at variance with clause (B).

The Commission also places reliance (R. 265-266) upon certain remarks during the debates of Representatives Huddleston and Cooper, both active opponents of any comprehensive "elimination" provisions. In this connection, this Court has frequently stated that statutes are not to be construed on the basis of remarks made during debates by opponents of the legislation. See *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S. 488, 493-494 (1931). But apart from that fact, the remarks in question,[29] as well as the entire speeches from which they were drawn (79 Cong. Rec. 14166-14167), show on their face that they were not speci-

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[29] The remarks in question, as quoted by the Commission, were as follows (see R. 265-266):

Mr. Huddleston (79 Cong. Rec. 14167):

> "The Rayburn proposal is merely the 'death sentence' in a different form of words. . . . To the uninformed, compliance may seem a possibility, but to those with knowledge of the industry they are a mere gesture . . . In short, the pretense of permission to hold more than one system adds nothing to the proposal . . .
>
> "The proposed Section 11 . . . requires the dissolution of all holding companies other than those of the first and second degree, *and in practical effect restricts each of them to a single utility system.* Under it the dissolution or reorganization of practically all the important companies will be forced."

Mr. Cooper (79th Cong. Rec. 14166):

> "The second condition for more than one utility system exists 'if all of such additional systems are located in one State or in adjoining States.'
>
> "That provision is of little importance since, as stated, most of the utility holding companies have acquired their properties in different territories in order to diversify the risk . . .
>
> "I submit to you that the exception granted on the basis of these three conditions does not materially modify the limitation to one integrated public-utility system, nor will it in any way prevent the dismemberment of practically all utility holding companies."

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fically directed to the meaning of clause (B) but rather to the practical effect of the *combination* of clauses (A), (B) and (C). It should be borne in mind that these two gentlemen had opposed *any* geographical restrictions, and from their point of view, the two-area compromise was little more satisfactory than the one-area Section 11 of the Senate; and their remarks are as applicable to the two-area interpretation as to the one-area interpretation (and see the remarks of Mr. Mott, footnote 28, p. 101, *supra*).

The Commission emphasizes the fact (R. 265) that at no time during the period from August 21st to August 24th did anyone specifically attribute a two-area interpretation to the compromise Section 11. In view of the fact, however, that clause (B) itself clearly states the two-area interpretation, and the further fact that during the debates clauses (A), (B) and (C), under which a two-region system could result only if the A and C standards were also met, were usually discussed as a combination, the truly significant fact is that *at no time, prior to passage of the Act, did anyone ever attribute a "one-area" interpretation to clause (B);* and no such interpretation was expressed either in the President's letter of August 21, 1935, or in the Conference Report.

It is true that shortly after the Bill was passed by the Senate, Senator Wheeler made a speech (79 Cong. Rec. 14479; R. 267) in which he attributed the one-area view to the compromise measure—*this being the only clear expression of the one-area view in the entire legislative history.* Clearly, however, a statement by a Senator, made *after the Senate had acted on the Bill,* cannot be looked to as indicating the Senate's intention in passing the Bill, especially since (1) Senator Wheeler had been an ardent partisan in favor of extreme "elimination" provisions,

(2) he had declined to make a statement on the compromise Section 11 prior to its passage by the Senate although specifically invited to do so by Senator Norris during the pendency of the motion to adopt the Conference Report (79 Cong. Rec. 14470), and (3) his statement was made in the confusion of the closing hours of Congress *and after the bitter controversy over the elimination provisions of the Act was deemed settled.*

Petitioners believe that the Commission and the court below lost sight of the fact that it was their function to construe the *statute* and not the Conference Report and the debates. In this connection it should be noted that after a review of the legislative history, the court below said (R. 1215):

> "*The matter is not free from doubt* but in our view the interpretation of the Commission is correct. The quoted passage from the Conference Report speaks in sequence of 'additional integrated systems', 'these additional systems', 'a principal integrated system', 'such additional systems' and concludes with the proviso that 'all such integrated systems are located in the same State or States or in adjoining States'. *This final clause is broad enough to include* both the previously mentioned 'principal integrated system' and also the 'additional systems', and it is a weighty circumstance that this meaning was publicly attributed to paragraph (B) in the Senate by one of the conferees before the present controversy had arisen".

Even after giving effect to the statements in the Conference Report and debates most heavily relied upon by the Commission, the court below admits that the matter is "not free from doubt"! We thus have the extraordinary situation where unambiguous language in the statute has

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been construed in an admittedly dubious manner on the basis of ambiguous language in a Committee Report and during the debates! Petitioners submit that if clause (B) is to be given a construction at variance with the natural meaning of the language used on the basis of legislative history, such history should itself be so clear as to remove the matter from the realm of doubt. The fact that it does not do so is admitted by the court below.

The same comment may be made with respect to the court's statement (R. 1215) that the final clause in the paragraph above quoted from the Conference Report is "broad enough to include both the previously mentioned 'principal integrated system' and also the 'additional systems' . . .". If the language is merely "broad enough" to include both the principal and the additional systems, without making it *necessary to include both*, the language is clearly ambiguous. Surely, the courts may not add words to, or delete words from, clause (B) on the basis of a Committee Report, unless such committee report is so clear as to leave no reasonable doubt as to the legislative intent. This obviously is not the case.

How slender is the reed upon which the Commission and the court below rely for their one-area interpretation is apparent when the Conference Report and Senator Wheeler's *post hoc* speech are examined in light of the definition of the phrase "integrated public-utility system" in Section 2(a)(29). The Conference Report states (p. 104, *supra*) that the A B C standards permit the retention of additional systems "where a holding company can show a *real economic need* on the part of additional integrated systems for permitting the holding company to keep those additional systems . . ."; and Senator Wheeler's speech states (79 Cong. Rec. 14479; R. 268) that

the furthest concession which the Senate conferees felt they could make was to permit the Commission to allow a holding company to control more than one integrated system if the additional system were in the same region as the principal system and "were so small that they were *incapable of independent economical operation* . . .". When both these comments are compared with the language of clauses (A), (B) and (C), it is apparent that they are loose and inaccurate. The fact is that if any systems had a "real economic need for retention" in a holding company system or were "so small that they were incapable of independent operation", *they could not qualify at all as integrated systems under Section 2(a)(29)*, which defines an integrated system as one "which under normal conditions may be *economically operated* as a single interconnected and coordinated system. . . ." If this definition means anything it means a system capable of being economically operated by itself. The test of retainability under clause (A) is whether the retainable integrated system cannot be operated independently without a loss of "substantial economies". There is no requirement whatever, under any of the A B C standards, that additional systems must possess an "economic need" for retention or be "so small as to be incapable of independent operation"; and, in fact, any such requirement would be wholly inconsistent with the definition in Section 2(a)(29).

Notwithstanding these extreme confusions of thought in both the Conference Report and Senator Wheeler's speech, the Commission and the court below rely heavily thereon in arriving at the conclusion that clause (B)—which obviously was drafted with more care than either the Conference Report or Senator Wheeler's speech—means something fundamentally different from what it says. This, we submit, is not interpretation but legislation.

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C. The So-Called Rationale of Section 11(b)(1)

The Commission and the court below attempt to support their interpretation of clause (B) by ascribing allegedly "absurd" (R. 270-275) and "irrational" consequences to the two-area interpretation. Practically the sole absurd consequence thus attributed to said interpretation is that it would permit the retention of additional systems in distant areas while precluding retention of additional systems adjoining the principal system (R. 274). As an example of this, the Commission states that under the two-area interpretation, if Engineers retains Gulf States and/or El Paso (Texas) as systems additional to Virginia, it could not also retain the gas system operated by Virginia since all of Virginia's additional systems would not be located in the same State or adjoining States (R. 270).

This, we respectfully submit, is an extraordinary argument. It is entirely predicated upon the Commission's holding, still untested in the courts, that a utility company operating a combined gas and electric system in a single area is engaged in operating two separate "integrated public-utility systems", as that term is defined in Section 2(a)(29). There is, however, nothing in the Act which requires such a joint operation to be regarded as two separate utility systems, *and the Commission's original view was to the contrary.* Thus, in *American Water Works and Electric Co., Inc.*, 2 S. E. C. 972 (1937), the Commission, in holding that an electric and gas system owned and operated by a single company together constituted a single system, said (p. 983):

> "No specific mention is made in the definition of an integrated public utility system concerning a combined gas and electric system. We believe, however, that it is proper to regard such a combined property as a single integrated system, provided

that all of the electric properties are integrated and all of the properties, both gas and electric, are in fairly close geographic proximity and are so related that substantial economies may be effectuated by their coordination under common control.

"The evidence adduced in this case warrants the conclusion that the combined electric and gas operations are so interrelated as to justify this Commission's findings that the two types of public utility enterprises carried on by applicant's subsidiaries *constitute together a single public utility system.*"

It is true that subsequently, on the basis of a technical interpretation of the statutory definitions, the Commission reversed itself, and held that a combined gas and electric system constitutes two separate utility systems. But Congress cannot be regarded as having had clearly in mind a technical construction of the Act which the Commission itself at first rejected; and accordingly any alleged irrational consequences resulting from such construction of the Act, when read in the light of the "two-area" interpretation of clause (B), can scarcely be looked to as indicating any legislative intent as to the purpose of clause (B).

As a matter of fact, upon balance, the "one-area" interpretation would seem to produce a much more disturbing array of irrational consequences than the "two-area" interpretation. Thus, for example, under the one-area interpretation a holding company with its single system in Rhode Island would, under the B standard, necessarily be confined in its operations to that State and the two adjoining States of Massachusetts and Connecticut, having a combined area of 14,480 square miles; whereas a holding company with its single system in Missouri would, so far

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as the B standard is concerned, be free to expand its operations throughout nine large States, namely, Missouri, as the single system State, and the adjoining States of Iowa, Nebraska, Kansas, Oklahoma, Tennessee, Kentucky, Arkansas and Illinois, having a combined area of 547,529 square miles. The area of operations in the latter case would be over 37 times as large as in the former case. Similarly, a holding company with a single system in California could, so far as the B standard is concerned, operate additional systems in the adjoining States of Oregon and Arizona, separated by approximately 1200 miles, whereas a holding company with its single system in Rhode Island could not hold additional systems separated by more than approximately 250 miles; the distance in one case being about five times greater than in the other. A more illogical or arbitrary geographical test as applied to the United States could hardly be devised!

The fact is that a compromise of such fundamentally conflicting theories as those behind the conflicting House and Senate views as to Section 11 is by its nature likely to be illogical and arbitrary when applied to certain situations. But, in any event, the argument of arbitrariness is wholly inadmissible when the one-area interpretation produces more irrational consequences than the two-area interpretation.

The "one-area" interpretation is gravely prejudicial to Petitioners since the result most earnestly desired by Engineers is the retention in its holding-company system of both Virginia and Gulf States, and if possible, El Paso (Texas). As a result of the Commission's interpretation of clause (B), Engineers was foreclosed at the outset from establishing that such combination would meet the A and C

standards. Petitioners contend that this Court should correct the Commission's misinterpretation of clause (B) and remand the case for a rehearing in the light of such correction.

V I

The words "substantial economies" in clause (A) of Section 11(b)(1) are fully satisfied by proof of substantial savings in operational expenses resulting from retention of control by the holding company

Under clause (A) of Section 11(b)(1) a holding company cannot continue to hold one or more integrated systems in addition to its "single" system unless—

> "(A) Each of such additional systems cannot be operated as an independent system without the loss of *substantial economies* which can be secured by the retention of control by such holding company of such system;"

Issue as to the meaning of the words "substantial economies" arises in connection with the retainability in the Engineers' system of two gas businesses located, respectively, in Norfolk, Virginia, and in Baton Rouge, Louisiana. The former gas business (herein usually called the Virginia gas business or gas system) is owned and operated by Virginia in connection with, and in the area of, its electric and other businesses (R. 99). The latter gas business (herein usually called the Gulf States gas business or gas system) is owned and operated by Gulf States in connection with, and in the area of, its electric and other businesses (R. 129-130).[30]

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[30] The question of the retainability of the Virginia gas business arises if Virginia shall be the single system of Engineers as directed by the Commission. The question of the retainability of the Gulf States gas business arises—

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Reversing its original holding that a combined gas and electric system constitutes a *single* public-utility system [see *American Water Works and Electric Co. Inc.*, 2 S. E. C. 972, 983 (1937)], the Commission in the case at bar held, first, that the Virginia gas business was independently "an integrated public-utility system" within the meaning of Section 2(a)(29)(B) of the Act (R. 99). It then held (R. 100-101) that the continued combination of the Virginia gas and electric systems was compatible with the geographic requirements of clause (B) and the size requirements of clause (C), but that the record did not establish that a "loss of substantial economies" would attend the severance of the two systems, and hence held that under clause (A) the Virginia gas system could not be retained with the Virginia electric system (R. 106). In order to reach this conclusion, as shown more fully later, it was necessary for the Commission, first, to interpret the words "substantial economies" as requiring something more than admitted large savings in operational expenses (resulting from the *combination* of the gas and electric systems), and then to assume, *without any foundation in the record,* that wholly conjectural "economies" incident to *separate operation* of the gas and other businesses would more than counterbalance admittedly large savings incident to their combined operation. A majority of the court below sustained the Commission's interpretation and finding (R.

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(1) if this Court shall hold, as contended in Point V, *supra,* that under clause (B) of Section 11(b)(1) both Virginia and Gulf States may be retained by Engineers, and the Commission shall hereafter find that both Virginia and Gulf States may be retained by Engineers under clauses (A) and (C) of Section 11(b)(1), or

(2) if Engineers, as contended in Point IV, *supra,* has the right to choose, and shall choose, Gulf States as its single system.

1218-1220). One judge, rejecting the Commission's interpretation of clause (A), held that proof of substantial savings in operational expenses resulting from the combination of the Virginia gas and electric systems fully met the statutory test on the record in this case (R. 1220-1221).

The same situation prevails with respect to the Gulf States gas business. There, also, the Commission found first (R. 130) that the Gulf States gas business was independently an "integrated public-utility system" under Section 2(a)(29)(b). It then held (R. 130, 134) that the continued combination of the Gulf States gas and electric systems was compatible with the geographic requirements of clause (B) and the size requirements of clause (C), but not compatible with the "substantial economies" requirement of clause (A). The court below apparently divided on this issue also, with the majority supporting the Commission and the dissenting judge holding that "the admitted facts establish the retainability of the Gulf gas system as an additional system, if Gulf States is chosen as the principal system" (R. 1222).

Certain "savings" claimed by Petitioners to result from the continued combination of the gas businesses with the electric and other businesses (in the case of both Virginia and Gulf States) were disputed by the Commission. Disregarding the disputed savings, for purposes of this brief, Petitioners contend that the Commission's interpretation of clause (A) is clearly erroneous, and that, on the *admitted facts*, the gas businesses are retainable with the other businesses.

A. The Admitted Facts as to the Virginia Gas System

The Virginia gas system serves an area of 35 square miles in Norfolk, Virginia, and environs (R. 577). The

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combination of the gas and electric properties in Norfolk dates back to 1900 (R. 547-548). While a separate corporate entity was retained for the Virginia gas properties until 1930, it was in fact operated as a department of Virginia for a considerable period before that time (R. 548-549).

This long-continued operation of the Virginia gas and other properties under single ownership has resulted in many inter-relationships which are productive of operating economies. There are 387 employees who work for both the gas and other properties of Virginia (R. 843, 845, 846). Properties having an aggregate book value of $2,178,013 are used jointly for the gas business and the other businesses. These include general office buildings and equipment, storerooms, automobiles, trucks, garage and shop equipment, and one right-of-way (R. 778, 822-828, 833, 834). There are also numerous inter-departmental transactions, such as sale of gas and electricity, which make for economies (R. 790, 814-822, 842).

This joint method of operation results in savings which would be lost upon a separation of the gas business from the electric business. These savings are of two classes: first, actual expenses presently incurred by Virginia's electric and other businesses and allocated to the gas operations, which could not be avoided in the event of separation, but would have to be borne by the remaining businesses of Virginia; and second, the excess of the estimated cost of operating the Virginia gas properties as an independent business over the present cost of its unified operation by Virginia. *Admittedly,* savings of the first class aggregate $55,969 annually, resulting chiefly from the joint use of personnel and properties (R. 331, 579-599, 850-856),[31]

[31] That is, even after discharging 21 employees as a result of separating the gas properties from the other properties, and thus re-

and savings of the second class aggregate at least $35,761 annually.[32] *The total annual savings of these two classes is thus $91,730.*

B. The Admitted Facts as to the Gulf States Gas System

The Gulf States gas system serves Baton Rouge, Louisiana, and environs, all within the service area of the Gulf States electric system (R. 667-669, 684). The gas system has been operated jointly with the electric system since 1900. Here again, there are many inter-relationships between the two properties which are productive of operating economies. Aside from four executives who supervise both gas and electric operations, there are 200 other joint employees, 45 of them engaged in customers' accounting and collecting, 30 in new business and sales activities, and 125 in accounting and general activities (R. 698-699). The general office building and the service building in Baton Rouge are jointly used by both the gas

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ducing the aggregate annual payroll by $28,100, there would still remain $59,969 of expenses now charged to the gas operations which would have to be borne, as *additional* operating expenses, by the other businesses of Virginia. The amount of this saving is not questioned by the Commission.

[32] The excess cost of independent operation of the gas business over the present cost of unified operation was determined by comparing the allocated costs for the operation of the Virginia gas properties with the estimated costs of operating said properties as an independent business. This estimate (R. 579, 584-608, 847-848, 858-862) was prepared by the operating executives of Virginia having closest familiarity with the gas system; *and no other evidence as to this matter was offered.* As thus determined this second class of savings amounted to $71,522 (R. 599, 863). In respect of this testimony the Commission found (R. 105), despite the fact that no countervailing evidence was introduced, that the record "would not sustain a finding of more than one-half of the claimed increased *expenses*" (italics in original). Taking this finding of the Commission at its face value, for purposes of this brief, the admitted savings of the second class would be not less than ½ of $71,522, or $35,761.

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and electric businesses. The service building houses all the operating department heads, the engineering offices and the joint meter testing department. It is also used for the joint storage of materials and supplies. The automobile fleet is a joint pool for the use of both divisions (R. 677-678).

This joint method of operating results in substantial savings which would be lost under separate operation (R. 864, 699-708), such economies being of the two classes above described. Economies of the first class admittedly aggregate $52,452 annually, resulting chiefly from the joint use of personnel and property (R. 864);[33] and economies of the second class aggregate at least $25,000.[34] *The total savings of the two classes is thus not less than $77,452 annually.*

C. Interpretation of Clause (A) by the Commission and the Majority of the Court Below

In holding that the record did not establish that a "loss of substantial economies" would attend the severance of the Virginia gas properties from the Virginia electric and other properties, the Commission emphasized the fact that in prescribing the conditions under which additional sys-

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[33] That is, even after discharging 18 employees as a result of separating the gas properties from the other properties, and thus reducing the aggregate compensation by $27,840, there would still remain $52,452 of expenses now charged to gas operations which would have to be borne, as additional operating expenses, by the other businesses of Gulf States. The latter amount is not questioned by the Commission (R. 131, 864).

[34] Petitioners introduced a comprehensive study (R. 864-880) showing the excess cost of independent operation of the Gulf States gas business over the present cost of unified operation. Said survey, which is the only evidence of record on this point, shows that the gas operations would sustain additional expense of $42,024 annually if conducted as an independent business (R. 864). The Commission questioned some of this amount, but was content to recognize at least $25,000 thereof (Com. Counsel Br. below at p. 99).

tems may be retained, Congress did not speak in terms of increased *expenses* but in the terms of the "loss of substantial *economies*" (R. 102). It then said that in measuring the loss of economies accompanying the severance of the combination of two utility systems, it was necessary to consider the "beneficial effects of independent ownership upon the efficient operation of each system"; and that where, as here, gas and electric operations are conducted in the same territory and compete with each other "the danger exists that under a single management one business may be suppressed in favor of the other"; and further that "the possible benefits of unsuppressed development and growth for each business must also be cast in the balance when the benefits of substantial economies are measured" (R. 102-103). On the basis of such generalities, and notwithstanding the entire absence of any evidence with respect thereto, the Commission concluded that "the loss of economies would in fact be less than such increased expenses" (R. 105). Having reached this conclusion, the Commission further held that the proved substantial savings in operational expenses were not sufficient to meet the test of clause (A) since "we must require clear and convincing evidence of the loss of economies *which would seriously impair the effective operations of the systems involved* in order to permit the retention of an additional system" (R. 106).

The Commission's interpretation of clause (A) was sustained by a majority of the court below as follows (R. 1219-1220):

> "It is our belief that the Commission could not legally 'permit' the continued control of 'Virginia Gas' by 'Virginia Electric' unless it could be found from the evidence adduced at the hearing:

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"(a) That there would be a continuing substantial strength enjoyed by the controlled company which it would not have under its own control.

"(b) That there would be in the situation no reasonable expectation that a compensating strength would not be enjoyed by reason of its own control.

"(c) That such continuing strength would not entail a sacrifice upon the part of the controlling utility.

"In short, we are of the opinion that the mere showing of a material saving in operational expense (which, to some extent at least, would normally be expected) does not necessarily show the overall situation. This single item may or may not indicate a net economy of any figure."[35]

D. The Minority Opinion of the Court Below

Rejecting the Commission's interpretation of clause (A) on the ground that it did not give "sufficient effect to the obvious intent of Congress to protect an established association of public utility systems under common control" when such association was found to satisfy the ABC standards (R. 1220), Judge Soper held that the Commission was required to give as much weight to the (A), (B), (C) clauses as to the provisions of Section 11(b)(1) immediately preceding them. He stated that this was a reasonable conclusion because the evils which the statute was designed to eradicate do not prevail under the conditions prescribed in clauses (A), (B) and (C), and, further,

[35] The majority opinion of the court below did not deal separately with the Gulf States gas system but left its conclusion as to that situation to inference from its conclusion as to the Virginia gas system.

that "it is certain, as the legislative history shows, that the Act would not have received the approval of Congress if it had not contained the provisions which prohibit the unnecessary disturbance of existing conditions" (R. 1220). Judge Soper further said (R. 1220-1221):

> "* * * It is putting it too strongly to say, as the Commission did, that there must be clear and convincing evidence of loss of economies which would seriously impair the efficiency of the systems. The Act does not require more than a preponderance of evidence to support such a finding; nor does it require that *the economies must be so great that their loss would seriously impair the system. Such a loss would not be merely substantial; it would be destructive.*
>
> "A loss of substantial economies occurs if they are so large that experienced men of affairs would regard them as substantial and if possible, take steps to eliminate them. An annual loss of $91,730, that is $55,969 plus one-half of $71,522, even in a business as large as that of Virginia Electric and Power Company, would meet this test and the unnecessary toleration of such a loss by management would subject it to justifiable criticism by investors and by state authorities charged with the duty to protect consumers from unnecessary expense. * * *
>
> "The conjecture of the Commission that compensating advantages might result from separate management adds no weight to the findings, *for the sufficient reason that it is entirely without support in the evidence.* * * *
>
> "* * * The conclusion of the writer is that there was no substantial evidence to warrant the finding that there would be no loss of substantial economies in the separation of the gas from the electric utility system of Virginia, and that the order of the Commission in this respect should not be sustained."

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For like reasons Judge Soper held, with respect to the Gulf States gas system at Baton Rouge, that the $77,000 of admitted annual savings resulting from unified operation established the retainability of that gas system, if Gulf States were chosen as Engineers' single system (R. 1221-1222).

E. The Interpretation of Clause (A) by the Commission and the Majority of the Court Below, as Requiring Something More Than Substantial Increases in Operational Expenses Resulting from Independent Operation, is Clearly Erroneous

Petitioners contend that the Commission's interpretation of clause (A) is clearly erroneous. The statute does not speak of a "loss of economies which would seriously impair the effective operations of the systems involved" (R. 106), nor does it use the language employed by the majority of the court below in sub-paragraphs (a), (b) and (c) of the above-quoted statement (p. 121, *supra*) from the court's opinion. The statutory phrase is "loss of substantial economies". Plainly, the avoidance of an expense is an economy. Indeed, the most obvious, natural and usual way of achieving an economy is to avoid an expense.

It is conceded that the question of "substantial economies" under clause (A) must be determined on a net basis; and that the economies of combined operation are to be offset by the economies, if any, of separate operation. Our contention is that proved and admitted economies of combined operation are not to be set aside for naught on the basis of wholly *conjectural and speculative* savings which are *imagined* to be a *hypothetical* result of separate operation when the record contains no evidence as to any such savings.

Clause (A) is a part of the legislative mechanism whereby, under certain circumstances, two utility systems which have been operating under common control are to be severed and thereafter operated independently. Under that clause the issue is whether such independent operation will result in the "loss of substantial economies"; or to put it differently, whether independent operation would lead to substantial losses. In deciding this issue the only *tangible* fact is the effect of the separation upon operating expenses. If the tie is to be severed, separate staffs will have to be set up for work now done by joint employees. Separate offices, service buildings, storage facilities, etc., will also have to be established. The size and character of such separate establishments may be easily visualized; and on the basis of past costs under joint operation reasonably definite estimates may be made as to the costs of independent operations. The difference between such estimated costs of independent operation and the actual costs of unified operation, as shown by the books, is a mere matter of subtraction. If the costs of the separate establishments is substantially more than the costs of the joint establishment, obviously there is a loss of substantial economies under independent operation "which could be secured from the retention of control" by the holding company.

To give clause (A) a broader meaning than this would involve the Commission in a speculation as to the legislative intent. The matter was succinctly put by Judge Soper when he said (R. 1220):

> "If the terms of paragraph (A) are given *normal meaning and weight,* it is hard to understand why substantial savings in operational expenses do not amount to the 'substantial economies' upon which the application of the paragraph depends."

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Support for this conclusion is found in the extreme uncertainty and practical difficulties which attends the Commission's construction of clause (A). The decrease or increase in operational expenses resulting from a severance of combined properties is a tangible fact which can be established with practical certainty. But once the inquiry shifts to such nebulous factors as the "possible benefits of unsuppressed development and growth" (see R. 103) we depart from the field of tangible facts and enter an area of conjecture and speculation. Such a step would, for example, require the Commission to predict and evaluate the character, skill, and even the policies, of future management, and the ability of such management to deal with presently unforeseeable competitive and other conditions. The effects of such factors upon the earnings and expenses of the severed systems are quite beyond the realm of evidentiary proof. They are not merely "not predictable in precise mathematical terms" as suggested by the Commission (R. 103); they are not predictable at all in terms of admissible evidence, nor are they even measurable by any form of intelligent guess from the evidence.

It is not necessary, however, to labor this contention. Even if it be assumed, for argument, that the Commission is entitled, under clause (A), to go beyond the field of operational expenses and determine the "beneficial effects of independent ownership" on the basis of wholly intangible factors, such as changed competitive conditions resulting from the separation, the Commission's determination in the case at bar cannot be supported because here there is no evidence whatsoever that such factors (i.e., in event of a severance of the Virginia and Gulf States gas businesses) would tend to *diminish* rather than *augment* the admitted increases in operational expenses. While the Commission found (R. 105) that "the loss of economies would in fact

be less than such increased expenses," this finding is a bald guess without support in the record. It was not even an informed guess since, in the language of Judge Soper, it "is entirely without support in the evidence" (R. 1220).

As pointed out by the minority Judge (R. 1221; and see R. 328-334, 346-351), "No one in the present case questions the efficiency of the present joint operations". That being so, there was no basis for the Commission to assume that other officers and employees, working solely for the "severed" gas businesses, would render services of greater value to such businesses than those rendered by the present officers and staff so as to offset the admittedly increased expenses incident to the severance. If the Commission is to be permitted, without evidentiary basis, to offset proved substantial economies by so-called "counter-vailing advantages", claimed to result from imagined increases in income which *might or might not* result from severance or from other imagined intangible advantages that *might or might not* be obtained by a separate staff of officers and employees, then in effect the legislative standard set forth in clause (A) may be nullified by the Commission at will. In fact, the standard completely disappears.

Admittedly, the record establishes that severance of the Virginia gas business from Virginia's electric and other businesses (and, likewise, severance of the Gulf States gas business from the Gulf States electrical and other businesses) would result in substantially increased operational expenses. The result of the Commission's interpretation of clause (A) is to impose these very substantial amounts of avoidable operational expenses on investors and consumers, notwithstanding the declared policy of the Act to protect investors and consumers (see R. 1221). This result has

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been accomplished by speculation as to wholly conjectural and unmeasurable "over-all economies" which might or might not result from changed competitive conditions in the event of independent operation, as to which there is no evidence in the record and as to which no real evidence could be presented. Clearly, Congress did not contemplate any such result.[38]

F. On a Correct Interpretation of Clause (A), the Evidence in the Record Amply Meets the Test as to Both the Virginia and Gulf States Gas Systems

In *Otis & Co.* v. *S. E. C.*, 323 U. S. 624 (1945), the Court said (p. 638) that—

> "• • • We must assume that Congress intended to exercise its power with the least possible harm to citizens."

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[38] If the Commission's conclusions respecting the Virginia and Gulf States gas properties reflect a belief that it is not sound public policy to have both gas properties and electric properties in a single community owned and operated by the same management, a complete answer is found in the fact that Congress considered this precise point and rejected a specific provision against joint ownership of gas and electric properties, thus permitting such joint ownership unless prohibited by local legislation (cf. Section 8(b) of S. 1725, 74th Cong., 1st Sess., with Section 8 of the Act in its present form). As admitted by the Commission itself in *American Water Works and Electric Co., Inc.*, 2 S. E. C. 972, 983, footnote 3, Section 8 as it now stands in the Act clearly leaves this question of policy to the decision of the local authorities. This same legislative policy is further evidenced by Section 9(b) of the Act which provides that the provisions of Section 9(a), prohibiting the acquisition of securities or utility assets, etc. without approval of the Commission, shall not apply if such acquisition "has been expressly authorized by a State Commission." Thus, for example, if Virginia did not own its present gas system, it would be specifically entitled, under Section 8 and Section 9(b) of the Act, to purchase the same, provided *only it secured the approval of the Virginia Corporation Commission.*

When clause (A) is correctly interpreted as being fully satisfied with proof of substantial loss of operational expenses which will arise from the separation, and when the word "substantial" as used therein is given its plain and ordinary meaning, there can be no question but that the evidence in the case at bar (which, admittedly, shows that severance of the Virginia gas business would entail increased operating expenses amounting to $91,730 annually; see pp. 117-118, *supra*) amply meets the statutory test. As pointed out by Judge Soper (R. 1221), any management which would unnecessarily tolerate such a loss "would subject it to justifiable criticism by investors and by state authorities charged with the duty to protect consumers from unnecessary expense." Since the protection of investors and consumers is a primary objective of the Act, such a loss unquestionably constitutes a substantial loss within the purview of clause (A).

In this connection, the Commission itself recognizes (R. 105, footnote 14) that even approximately one-third of said sum of $91,730 (*i.e.*, the sum of $35,761 which the Commission accepts as the increased costs of operating the Virginia gas properties as a separate business; see footnote 32, p. 118, *supra*) "would result in an increase of 4.6% in the 1940 gas operating expenses, and a decrease of 13.3% in the gross gas income for 1940 and 29.8% in the 1940 gas income available for dividends." Measured in another way, even this partial loss of $35,761 would amount to 150% of the total estimated executive compensation required to operate the Virginia gas properties as a separate business (R. 861). Such a reduction in income available for dividends alone would obviously have a material effect on the ability of the gas properties, as a separate system, to finance itself.

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What has been said above with respect to the Virginia gas business applies with even greater force to the Gulf States gas business. There, the undisputed evidence establishes, as admitted by the Commission, that severance would result in annual operational losses of at least $77,000 (see p. 119, *supra*). Relative to the total volume of operations, this is a more substantial loss than would be involved in event of severance of the Virginia gas business. Even the admitted annual savings to the Gulf States gas operations alone (*i.e.*, $25,000; see footnote 34, p. 119, *supra*) are "substantial". This amount alone represents approximately the total cost of all executive salaries and supervisory services which would be required for the gas business if operated as a separate business (R. 865). It approximates the total cost of all accounting and general office salaries, and it exceeds the total expenses that would be required for all customers' accounting and collection services, in the event of separate operation of the gas business (R. 867).

The Commission took the position that clause (A) requires "evidence of a loss of economies which would seriously impair the effective operations of the systems involved * * *" (R. 106). There is, however, nothing whatever in the statute to that effect. As the dissenting judge pointed out (R. 1221), "Such a loss would not be merely substantial; it would be destructive".

Admittedly, it is the Commission's function to find the facts, but the validity of the statutory interpretation by which the facts are appraised is a matter of the legal standard and thus is judicially reviewable. Because the Commission's consideration was governed by a misinterpretation of clause (A), Petitioners submit that this proceeding should be remanded to the Commission for reconsideration

of the question as to the retainability of the Virginia and Gulf States gas business under the proper statutory standard.

VII

The Commission, through a misinterpretation of the "other business" clauses of Section 11(b)(1), improperly ordered Engineers to divest itself of its interest in various non-utility businesses

Petitioners Virginia and Gulf States, both subsidiaries of Engineers, own various businesses "other than the business of a public-utility company as such" (i.e., other than an *electric* or *gas* utility), the retainability of which is governed by the so-called "other business" clauses of Section 11(b)(1).

Disregarding businesses which have been sold since the Commission's divestment order, such other businesses are as follows (see footnote 5, p. 5, *supra*):[37]

Gulf States	Water, ice, steam, electric appliance merchandising, and gas appliance merchandising
Virginia	Ice, electric appliance merchandising, and gas appliance merchandising

[37] When the Court of Appeals handed down its opinion Virginia owned and operated a combined street railway and bus transportation system within the area of its electric service (R. 373-376). In volume of operations, this was the most important of the "other businesses" in the Engineers system; and most of that part of the opinion of the court below which deals with the "other business" clauses of Section 11(b)(1) is devoted to the discussion of this particular business (R. 1226-1229). Recently Virginia sold its street railway and bus business (see footnote 5, p. 5, *supra*). As shown above, however, there still remain in the Engineers system important "other businesses" to which the present point has application.

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As the court below found, the Commission construed the "other business" clauses as requiring that it (R. 1224):

> "• • • must deny retention of any 'other business' unless it is incidental or necessary or appropriate to the *operations* of the principal system, *i.e.*, unless there is a functional relationship between the operation of the business and the operation of the principal system." (Italics in original)

On the basis of this narrow interpretation (R. 86-87, 89-90), the Commission permitted retention in Engineers' system of only those other businesses which it found to be *functionally related* to the operations of the particular public-utility system involved. Such functionally related other businesses are the Virginia ice business, which serves the function of heating the Virginia electric service building in winter and cooling it in summer and producing ice as a by-product (R. 96-97); the Gulf States steam business, which consists largely of the sale of steam produced in connection with the generation of electricity of one of the Gulf States electric plants (R. 127-128); and the Virginia and Gulf States *electric* appliance merchandising businesses, which are conducted solely for the purpose of load building (R. 98, 128-129) and which Petitioners do not regard as separate businesses at all. The Commission refused to permit retention of those businesses which are not functionally related to the operations of the several electric public-utility systems, *i.e.*, the Virginia gas appliance merchandising business (R. 98-99), and the Gulf States water, ice, and gas appliance merchandising businesses (R. 124-127, 129).[88]

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[88] An examination of the reasoning and ruling of the Commission (R. 86-87, 89-90) makes it clear, as the court below found (R. 1224, 1226, 1229), that the principal reason leading to its order for divest-

Rejecting the Commission's interpretation of the other business clauses, the court below said (R. 1225):

> "It seems clear to us that Congress did not contemplate this result, but intended, on the contrary, to forbid the divestment of other businesses, not detrimental to the functioning of the principal system, if retention will serve the interests of the general public or the interests of investors or consumers, irrespective of the functional relationship between these businesses and the principal system. The purpose to eliminate the evils of holding company systems is expressed in the Act in unmistakable terms, but in the provisions of the compromise measure, worked out in the legislative process, it also clearly appears that Congress realized that it was dealing with existing corporate structures that had been operated under common control for a long time and could not be cut down to a single ideal system in every case without disastrous consequences to public and individual interests. The purpose to protect these interests is made abundantly clear by an examination of the legislative history of the Act."

Petitioners submit, as the court below held and as more fully presented in sub-points A and B below, that the Commission's interpretation of the other business clauses is erroneous, and that therefore this case must be remanded for further consideration of the retainability of the remaining "other businesses" in light of a proper interpretation of said clauses.

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ment of the Virginia transportation and gas merchandising businesses (R. 89-96, 98-99), and the Gulf States water, ice, and gas merchandising businesses (R. 124-127, 129), was the absence of any functional relationship between such businesses and the related utility systems. In fact, with respect to the Gulf States water business there are no findings at all except those relating to the absence of a functional relationship (R. 124-126).

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A. The "Other Business" Clauses of Section 11(b)(1) Do Not Contemplate a Functional Relationship Between a Retainable "Other Business" and the Related Public-Utility System

1. A functional relationship is not contemplated by the language of the "other business" clauses

The *first* of the two "other business" clauses is found in the first part of Section 11(b)(1), which directs the Commission to require each holding company to limit its operations to a single integrated public-utility system and "*to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system;* * * *." Then, following the proviso containing the ABC standards for the retention of additional integrated systems, comes the *second* other business clause—the last sentence in Section 11(b)(1)—which reads as follows:

> "The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems."

The context of the two other business clauses makes it clear that the second clause was designed to elaborate and clarify the first. In effect, therefore, the second other business clause specifies that such an other business will meet the two alternative requirements of the first clause (*i.e.*, that such business be "reasonably incidental, or economically necessary or appropriate" to the operations of the integrated public-utility systems) if the Commission

shall find that its retention is necessary *or* appropriate (i) in the public interest, *or* (ii) for the protection of investors, *or* (iii) for the protection of consumers, *and* (iv) not detrimental to the proper functioning of the integrated system or systems. To put it differently, the second other business clause is explanatory, of and not additional to, the first. If the standards of the second clause are met, retention of the other business is *per se* "reasonably incidental, or economically necessary or appropriate." These words, from the first clause, cannot, as the Commission decides, be held to require some further condition to retainability, for that would squarely contradict the express statement in the second clause.

It should be further noted that the first three standards in the second other business clause, namely, public interest, protection of investors, and protection of consumers, are in the *alternative*. Furthermore, as to each of these first three standards the words "necessary" and "appropriate" are used in the alternative. Thus, a holding company may retain an interest in any business which the Commission shall find necessary or appropriate (i) in the public interest *or* (ii) for the protection of investors *or* (iii) for the protection of consumers *and* (iv) not detrimental to the proper functioning of such system or systems. The only one of these standards which must be met in any event is (iv).

It is significant, as the court below pointed out (R. 1223), that originally the Commission itself adopted the view, here urged by Petitioners, that the second other business clause explains and qualifies the first other business clause. Thus, in *The United Gas Improvement Company*, 9 S. E. C. 52 (1941), the Commission said (p. 73):

> "We must conclude that the two clauses in Section 11(b)(1) which refer to the retention of

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other businesses, when taken together, mean that the Commission *must*[39] permit the retention of other businesses, * * * which are found to be reasonably incidental or economically necessary or appropriate to the operations of an integrated public utility system retainable under the control of the holding company, and that * * * *these standards may be met if the retention of the investments or other interests is found to be necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems.*"

In the case at bar the Commission rejected the views it had stated so clearly in *The United Gas Improvement Company* case. Treating the first other business clause as quite independent of the second clause, and emphasizing the word "operations" in the first clause, the Commission held that the first clause could only be satisfied by the requirement of a functional relationship between the "other business" and the related utility system. In so doing, Petitioners submit, the Commission did violence to the plain meaning of the language used in the statute.[40]

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[39] In this connection the court below said (R. 1225, footnote):

"The concluding 'other business' clause in §11(b)(1) begins with the words 'The Commission may permit, &c.', which seemingly indicate a permissive authority rather than a mandatory duty. The word 'may' however, was given the meaning of 'must' by the Commission in its decision in the case of United Gas Improvement Company, *supra;* and this interpretation is not seriously challenged by the Commission in its present decision which introduces the theory of functional relationship."

[40] In further consideration of the Commission's interpretation the court below said (R. 1225, footnote):

"If the Act is interpreted as giving the Commission a broad discretion to forbid the retention of other businesses that are not detrimental to the functioning of the system, and are necessary or appropriate to the interest of the public or of investors or of consumers, doubtful questions of constitutionality may arise."

2. The legislative history of the "other business" clauses shows that a functional relationship is not required

Petitioners' contention that the second other business clause was intended to define situations in which all requirements of the first clause are satisfied and in which retention must be permitted is convincingly supported by the legislative history of these clauses.

Section 11 of the original Bill (S. 1725, 74th Cong., 1st Sess.), which was introduced on February 6, 1935 (79th Cong. Rec. 1525), did not contain either of the other business clauses, but required generally that holding companies dispose of securities or assets whenever the Commission found that the continued ownership or control thereof was not necessary or appropriate to the operation of a single integrated system. Section 8(a) of said original Bill, in substance, declared it unlawful for a holding company, directly or indirectly, to carry on any business except (1) that of an electric or gas utility, (2) any business expressly authorized by a State Commission, and (3) "such other business reasonably incidental to the foregoing as the Commission by rule, regulation or order may permit as necessary or appropriate in the public interest or for the protection of investors or consumers and not in contravention of the provisions of this Act".[41]

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[41] Sec. 8.(a) of the original Bill read as follows (S. 1725, 74th Cong., 1st Sess.; see Hearings before Senate Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess., p. 17):

"8.(a) After January 1, 1937, it shall be unlawful for any registered holding company to have any interest, directly or indirectly, through the ownership or control of securities by such holding company or by any of its subsidiary companies, or otherwise, in any business other than (1) the business of the production, generation, transportation, transmission, or distribution of gas and/or electric energy; (2) any other business carried on by a public utility company exclusively in a

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The interpretative memorandum which accompanied the original Bill on its introduction in Congress on February 6, 1935 (79th Cong. Rec. 1525) explained Section 8(a) as follows (Hearings before Senate Committee on Interstate Commerce on S. 1725, 74th Cong., 1st Sess., pp. 49, 55-56):

> "• • • registered holding companies are restricted to the gas and electric utility business and those operations reasonably incidental thereto. It is expressly provided in this subsection, however, that such additional public-utility business as an operating company is permitted to carry on by the State in which it is organized shall be allowed to continue. There is further a flexible provision giving the Commission power to include other incidental activities. *These provisions are so designed as not to cause interference with State policy which allows or fosters the carrying on of waterworks, traction business, bus systems, etc. by electric and gas utilities.*"

In the Senate substitute Bill (S. 2796), which was reported out favorably by the Senate Committee on Interstate Commerce on May 14, 1935, Section 8 was changed so as to be applicable only to future acquisitions of properties, and there was appended to Section 11(b)(1)[42] the requirement, in addition to the single system limitation, that holding companies retain only "such business as is reasonably incidental, or economically necessary or appropriate, to the operations of such system" (see S. Rept. No.

State or States where the carrying on of such business by such company is expressly authorized by the State Commission; and (3) such other business reasonably incidental to the foregoing as the Commission by rule, regulation or order may permit as necessary or appropriate in the public interest or for the protection of investors or consumers and not in contravention of the provisions of this Act."

[42] In the original Bill (S. 1725, 74th Cong., 1st Sess.) the comparable subsection was designated 11(b)(2).

621, 74th Cong., 1st Sess., pp. 7-8, 29-30). It should be noted that this language is substantially the same as the first other business clause (preceding the proviso relating to additional systems) in Section 11(b)(1) as finally enacted.

On June 7, 1935, when the Senate substitute bill (S. 2796) was debated on the floor of the Senate, the indefiniteness of the phrase "reasonably incidental, or economically necessary or appropriate" in Section 11(b)(1) (*i. e.*, the first other business clause) was the basis for an amendment designed to clarify its obscurity. The purpose of the proposed amendment is clearly shown by the following colloquy between Senators Minton, Wheeler and Johnson, which colloquy is extremely enlightening as to the meaning of the other business clauses (79 Cong. Rec. 8849):

> "Mr. MINTON: I offer the amendment, which I send to the desk.
>
> "The PRESIDENT pro tempore: The amendment will be stated.
>
> [The Chief Clerk then read the proposed amendment to append the following clause to Section 11(b)(1) after the clause 'such business as is reasonably incidental, or economically necessary or appropriate, to the operations of such system':]
>
> "; the Commission may permit, as being reasonably incidental or economically necessary or appropriate to the operations of such system, the retention of an interest in any business (other than the business of a public-utility company as such) in which such registered holding company or such subsidiary company thereof is engaged or has an interest if the Commission finds that such business is affected with a public interest and its rates or charges are regulated by law, and that the retention of such interest

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in such business is not detrimental to the proper functioning of a single geographically and economically integrated public-utility system.

"Mr. MINTON: Mr. President, the purpose of this amendment is to enable the holding company that has gas and electric properties and also water properties, we will say, by way of illustration, *to come within the purview of the proposed act without giving up its water properties.* Water properties, of course, are utility properties; they are affected with a public interest; and their rates and process, of course, are regulated entirely by the State commissions, and they are intrastate in their activities. Therefore this amendment would simply permit a holding company that comes within the purview of the bill as to its electric and gas properties, we will say, to retain such water properties as it may hold.

"Mr. WHEELER: Mr. President, let me say to the Senator that I have examined this amendment and I have not any particular objection in a geographically integrated district to a holding company having a *water company or some other company which is regulated by a public commission and which it has at the present time,* but we do, under the bill, propose to prevent them from going out and acquiring other such properties in the future; we propose to prevent them, even in this instance, from keeping those that they have if the Commission finds that their retention is detrimental to the public interest.

• • • • • •

"Mr. JOHNSON: Mr. President, the particular amendment of the Senator from Indiana [Mr. Minton] relates to a specific corporation, does it not? I ask the question because I have an instance here which I think relates to the same corporation.

"Mr. MINTON: I will say to the Senator it does. I had in mind in presenting this amendment the particular problem of the American Water Works Cor-

> poration, which owns several plants in my State in different towns. The amendment is designed to enable that company to retain its water properties and to bring its other properties within the purview of the proposed act."

The amendment offered by Senator Minton was adopted on June 7, 1935 (79 Cong. Rec. 8850) but was later withdrawn on the same day by consent upon Senator Johnson's request (79 Cong. Rec. 8850). Thereafter on June 10, 1935, Senators Johnson and Minton made the following statements, respectively (79 Cong. Rec. 8943-8944):

> "Mr. JOHNSON: Mr. President, I desire to call up an amendment of mine, as well as an amendment of the Senator from Indiana [Mr. Minton] which was presented last Friday evening.
>
> *"The amendment in which I am interested has been presented to those who are the sponsors of the bill, and they have rewritten it as a part of the amendment of the Senator from Indiana.*
>
> • • • • • •
>
> "Mr. MINTON: Mr. President, the first part of the amendment referred to by the Senator from California is the part which deals with the situation which I brought to the attention of the Senate by an amendment on last Friday.
>
> *"I will say to the Senate that the amendment now offered by the Senator from California incorporates in it the idea which I had in mind in my amendment, and fully meets that situation, and, if acceptable to the Senate, is agreeable to me. . . ."*

Thereupon, the Senate on the same day, adopted the following consolidated amendment to Section 11(b)(1), which, it will be noted, consisted of the Minton proposal as supplemented by the Johnson proposal,—the latter being clause (2) of the amendment (79 Cong. Rec. 8944):

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"The Commission may permit as reasonably incidental or economically necessary or appropriate to the operations of such system the retention of an interest in any business (other than the business of a public utility company as such) in which such registered holding company or such subsidiary company thereof is engaged or has an interest if the Commission finds (1) that such business is affected with a public interest and its rates or charges are regulated by law, and that the retention of such interest in such business is not detrimental to the proper functioning of a single geographically and economically integrated public utility system, or (2) that such business is solely that of owning and operating farm lands for agricultural or horticultural purposes and is carrying on experimental or developmental work in agriculture or horticulture, in connection with any State or any political subdivision, or educational institution of such State, for the improvement of agriculture or horticulture in such State."

It is apparent from the legislative history of the other business clauses up to this point that *the above amendment was offered and adopted to define certain types of business that the Commission must hold within the language of the first clause as "reasonably incidental or economically necessary or appropriate to the operation of such system * * *"*.

When S. 2796 came before the House, that body not only relaxed Section 11(b)(1) by permitting holding companies to retain as many integrated systems as the Commission might find consistent with the public interest (see pp. 97-98, *supra*), but also prohibited the Commission from requiring any holding company to divest itself of an interest in any business unless the Commission found such retention inconsistent with the public interest (H. Rept. No. 1318, 74th Cong., 1st Sess., p. 6; 79 Cong. Rec. 10639-10640).

Thereafter, as shown above (pp. 99-100, *supra*), S. 2796 was referred to a Conference Committee. The divergent House and Senate views were compromised by discarding the House Bill Section 11 *in toto*, and inserting the additional system proviso, with the A B C standards, between the original Section 11(b)(1) of the Senate substitute bill (S. 2796) and the appendant Minton-Johnson amendment. The language of the Minton-Johnson amendment was changed by the conferees, but all that they did was to insert in place of the particularized language of the Minton-Johnson amendment, which appears below in brackets, the general language, which appears below in italics (H. Rept. No. 1903, 74th Cong., 1st Sess., p. 20):

> "The Commission may permit as reasonably incidental or economically necessary or appropriate to the operations of [such system] one or more integrated public-utility systems[43] the retention of an interest in any business (other than the business of a public-utility company as such) [in which such registered holding company or such subsidiary company thereof is engaged or has an interest if the Commission finds (1) that such business is affected with a public interest and its rates or charges are regulated by law, and that the retention of such interest in such business is not detrimental to the proper functioning of a single geographically and economically integrated public utility system, or (2)

[43] The first other business clause of the Senate substitute Bill read "as reasonably incidental, or economically necessary or appropriate, to the operations of such system" (S. 2796, 74th Cong., 1st Sess.). In the Bill as finally adopted, which followed the Conference Report (H. Rept. No. 1903, 74th Cong., 1st Sess., p. 20), this clause was changed to read "as are reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems." This change was obviously made to conform the language of this phrase with the additional system proviso which was added by the conferees and is, of course, immaterial to the present discussion.

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that such business is solely that of owning and operating farm lands for agricultural or horticultural purposes and is carrying on experimental or developmental work in agriculture or horticulture, in connection with any State or any political subdivision, or educational institution of such State, for the improvement of agriculture or horticulture in such State] *which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems.*"

The foregoing legislative history leaves no doubt whatever as to the origin of the general language in the second other business clause adopted by the conferees, especially when such language is compared with Section 8(a)(3) of the original Bill:

Conference Proposal (i. e., the Act)	*Section 8(a)(3) of the Original Bill (S. 1725, 74th Cong., 1st Sess.)*
"which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems."	"such other business reasonably incidental to the foregoing as the Commission by rule, regulation or order may permit as necessary or appropriate in the public interest or for the protection of investors or consumers and not in contravention of the provisions of this Act."

The last phrase of Section 8(a)(3) of the original Bill, *i. e.*, "not in contravention of the provisions of this Act", was undoubtedly changed to "not detrimental to the proper functioning of such system or systems" because Section

1(c) of the Act, as changed by the conferees, declared that it was the policy of the Act to eliminate properties detrimental to the proper functioning of public-utility systems."[44] In all other respects the standards of the two clauses are identical.

It is thus clear that the second other business clause in Section 11(b)(1) is substantially identical with, and, indeed, was taken directly from, the corresponding provision of Section 8(a)(3) of the original Bill, and that this particular provision of Section 8(a)(3) of the original Bill was initially brought to the attention of the Congress under a covering explanation that its specific purpose was to permit the retention of "water works, traction business, bus systems, etc. by electric and gas utilities" (see p. 137, *supra*). In other words, the specific purpose of the provision was officially declared to be permission for the retention of other businesses not bearing any functional relation to the related utility systems. This fact, we submit, should be accepted as decisive as to the legislative intent.

In this connection, it may be pointed out that the substitution by the conferees of the general language of the second other business clause for the more specific language of the Minton-Johnson amendment was deemed so unim-

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[44] The history of this very clause, i. e., Section 1(c), which states the policy of the Act, has itself a bearing on the question whether a functional relationship was intended by the "other business" clauses. As Section 1(c) of the Act stood prior to the Conference, it declared that it was the policy of the Act to eliminate properties which were not "economically and geographically related *in operations* * * *." (S. Rept. No. 621, 74th Cong., 1st Sess., p. 22) In the Conference this phrase was stricken out and there was substituted in the Bill as approved in Conference and as finally enacted the provision declaring it to be the policy of the Act to eliminate properties "detrimental to the proper functioning of such systems * * *." (H. Rept. No. 1903, 74th Cong., 1st Sess., p. 3)

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portant that it was not explained,[45] either in the Conference Report or on the floor of Congress. This silence indicates that the final form of the second other business clause was not intended to restrict, but on the contrary to amplify, the objectives of the Minton-Johnson amendment, since the only reasonable inference to be drawn from the conferees' substitution of general language for the particulars of the Minton-Johnson amendment is that it was desired that the other business clauses should be *all-inclusive* to an extent consistent with the protection of the public interest, investors or consumers and the effectuation of the purposes of the Act.

In seeking general language which would permit the retention of the types of businesses mentioned in the Minton-Johnson amendment and all others consistent with the purposes of the Act, it was natural that the conferees should revert to Section 8(a) of the original Bill. It is significant, however, that in so doing the conferees passed over the particularized language of Section 8(a)(2) of the original Bill, which permitted the retention of any business expressly authorized by a State commission, and adopted the general language of Section 8(a)(3), which authorized the retention of any business which met certain standards. In thus adopting the general language of Section 8(a)(3) of the original Bill, the conferees unquestionably used it in the same meaning and with the same objectives that it had in the original Bill. There can be no doubt as to what such meaning and objectives were in view of the statement in the interpretative memorandum which accom-

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[45] By "explained", we mean elucidated. The Conference Report (H. Rept. No. 1903, 74th Cong., 1st Sess., p. 20), and Mr. Rayburn in his speech of August 22, 1935 (79 Cong. Rec. 14164), did refer to the other business clauses but only by repeating the precise language thereof.

panied the original Bill on its introduction in Congress (see p. 137, *supra*), to the effect that Sections 8(a)(2) and (3) "*are so designed as not to cause interference with State policy which allows or fosters the carrying on of waterworks, traction business, bus systems, etc., by electric and gas utilities*". No clearer showing could be made that the other business clauses were not designed to enumerate any requirement of functional relationship. The Commission accepted that result in *American Water Works and Electric Co. Inc.*, 2 S. E. C. 972 (1937), in which a holding company was permitted by the Commission to retain its interest in water, coal, electric railway, bus and bridge businesses.

In summary, the limitation on retainable non-public-utility-businesses was, in the original Bill, dealt with in Section 11 only as part of a blanket power, but was dealt with specifically in Section 8. It was dealt with in that Section by language that was proclaimed as permitting the retention of non-public-utility businesses that could not have any functional relation whatever with the electric utility business. Section 11 of the Bill was then amended in the Senate by substituting for the original blanket power the language of the first other business clause. As a result, Section 11 not only limited the retainable public-utility businesses, but also limited the retainable non-public-utility businesses. It is in this language that there is found the reference to "operations" on which the Commission bases its requirement of a functional relation between the principal electric utility business and the retainable non-public-utility business. But this language was promptly supplemented so as to permit the retention of *specified types* of

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non-public-utility businesses having no functional relation to the electric utility business (upon satisfying certain standards). That was the original form of the second other business clause. It was later enlarged, by an agreement, so as to permit the retention *of all types* of non-public-utility businesses, without reference to any functional relation to the electric utility business (upon satisfying the same standards). That is the final form of the second other business clause. This action in itself is a decisive rejection by the Congress of any requirement for functional relation. The point, moreover, is confirmed by the fact that the general language used for the enlarged final form of the second other business clause was taken from Section 8 of the original bill, which itself had been proclaimed as not referring to any functional relation. By two steps, therefore, the Congress clearly negated any requirement of functional relation between the principal electric utility business and the retainable non-public-utility businesses.

For the Commission to interpret these words as requiring a functional relation as a condition to retainability is, therefore, not only a distortion of the enacted words, but a contradiction of the manifest meaning of the legislative history. It is thus untenable and the court below was clearly right in disapproving the Commission's action.

B. The court below correctly held that in view of the Commission's misinterpretation of the "other business" clauses the case should be remanded to the Commission

Having first found that the Commission had misinterpreted the other business clauses as requiring a func-

tional relationship between any such other businesses and the related utility system, the court below further found that the Commission's "conclusions on this branch of the case were based *mainly* upon" such misinterpretation, *i. e.*, upon "the theory that the other businesses must have a functional relationship to the system * * *" (R. 1229).[46] That this is true is apparent not only from the Commission's opinion (R. 86-87, 89-90) but also because the Commission made no findings which would require divestment of the "other businesses" on any other ground (see footnote 38, p. 131, *supra*). In fact, the court below found (R. 1228), that there was "substantial evidence" from which the Commission might have found that retention of the Virginia's transportation business (which formed the basis of the court's discussion of this phase of the case; R. 1226-1229) was "necessary in the public interest or for the protection of investors or consumers, or if not necessary, at least appropriate for these purposes *in the ordinary acceptation of those terms,*" but that "in the absence of a functional relationship * * * no such finding could be made under the Commission's interpretation * * *."

The court below further stated (R. 1228) that the Commission gave as an additional reason for ordering the divestment of the Virginia transportation business that its retention had been detrimental to the proper functioning

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[46] To the same effect the court below also said (R. 1226) that the Commission's order for divestment of Virginia's transportation business—

> "* * * was based *for the most part* upon the lack of functional relationship between the transportation and electric utility business in accordance with the theory developed in the quoted passage from its opinion".

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of the Virginia electric system, this finding being based on certain past improper accounting practices. With respect to this point, the court pointed out that "faulty accounting practices which have occurred are not necessarily inherent in the situation and have been corrected or are in process of correction, according to the undisputed evidence", and stated that there had been no clear finding by the Commission as to the present situation in the light of such changes (R. 1229).

Upon this state of the record, the court below correctly held that the case should be remanded to the Commission for reconsideration of its findings in the light of the correct interpretation of the "other business" clauses. Petitioners submit that this decision is clearly correct.

In this connection it should be borne in mind that although Virginia's transportation business has been sold since the issuance of the opinion of the court below, there still remain, subject to the operation of the divestment order, the following "other businesses":

Virginia	Gas appliance merchandising
Gulf States	Water, ice, and gas appliance merchandising

If this Court shall hold, as Petitioners contend (Point VI, *supra*), that the Commission erroneously interpreted the "substantial economies" provision of clause (A) of Section 11(b)(1), and if, after a further hearing under a proper interpretation of clause (A), the Commission shall find that Virginia's gas utility business is retainable, then it will be necessary for the Commission to determine, under

a correct interpretation of the "other business" clauses of Section 11(b)(1), whether the gas appliance merchandising business of Virginia is also retainable.

Likewise, if this Court shall hold, as Petitioners contend (Point V, *supra*), that Engineers may retain both Virginia and Gulf States under clause (B) of Section 11(b)(1) and if, in that event, Engineers establishes that both Virginia and Gulf States are retainable under clauses (A) and (C), or if this Court shall find, as Petitioners contend (Point IV, *supra*), that the Commission should have left to Engineers the choice of its "single" system and Engineers should select Gulf States as such "single" system, it will then be necessary for the Commission to determine, under a correct interpretation of the "other business" clauses, whether the water and ice businesses of Gulf States are retainable; and if the Gulf States gas business is held to be retainable by Engineers, it will also be necessary for the Commission to reconsider whether the gas appliance merchandising business of Gulf States is retainable.

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CONCLUSION

For all the reasons advanced by the court below and upon the further grounds herein urged, the orders of the Commission should be set aside and the proceeding remanded to the Commission.

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October 15, 1945.

Appendix A

Analysis of Proffered and Excluded Evidence Bearing on Constitutional Issues

The Witness and his Qualifications

Dr. Merwin H. Waterman, economist, Professor of Finance in the School of Business Administration at the University of Michigan, was the witness whose testimony was proffered and excluded. Dr. Waterman graduated from the University of Michigan in 1925 with a degree of B. A. and took degrees as Master of Business Administration in 1926 and of Ph. D. in 1932 from that University. He has taught in that University from 1926 to date. He was an Instructor of economics and business administration from 1926 to 1929. In 1929 he became an Assistant Professor of Finance in the School of Business Administration and continued as such until 1936; he was an Associate Professor of Finance from 1936 to 1941, and in 1941 he became Professor of Finance. During this period of association with the University of Michigan he acted as Research Assistant in the Bureau of Business Research during the summers of 1927 and 1928, and as Research Associate in the Bureau of Business Research during the summers of 1929 and 1930, and as Assistant Director in the Bureau of Business Research throughout the years 1930 to 1937 inclusive, and during the summer of 1940. He has acted as Secretary of the School of Business Administration of the University of Michigan from 1937 to date. The Bureau of Business Research mentioned is a division of the School of Business Administration and this school is a graduate unit of the University of Michigan. He has written a number of magazine articles and two books dealing with public utilities (R. 895-6). The statistical studies made as a basis for his testimony bore directly on a previous research which Dr. Waterman had done (R. 905-6).

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In preparing the material for the proffered evidence, in supervising the work Dr. Waterman used all the time he could spare from his regular duties at the University of Michigan between August, 1940 and May, 1941 and kept two competent statisticians busy full time and in addition used part time assistance of several other workers (R. 905). In addition, as stated below, the tabulations required were done by the punch card (Hollerith) machine tabulating equipment. That work was done by the highly trained technical staff at the Sorting and Tabulating Machine Station of the University of Michigan, supervised by the department head who directs all similar work passing through that station (R. 920-922).

Purposes of Act

Counsel for respondents outlined to Dr. Waterman that in their opinion the ultimate or fundamental objectives of the Act were the protection of consumers of electricity and gas and the protection of investors in utilities; and they expressed the view that all of the abuses which the Act sought to correct and all the purposes sought to be accomplished thereby, were directly related in varying degrees to six factors, affecting either the public served or the investor in utility securities or both. Said six factors were as follows: (1) the cost of electricity and gas to consumers; (2) economy of management and operation of operating companies; (3) economy in raising capital for, and financial management of, utilities; (4) protection of investors in utilities; (5) effectiveness of regulation of utilities; and (6) adequacy and efficiency of service by utilities (R. 901). These six factors are not mutually exclusive but overlap each other and some are means to desired statutory ends rather than ends in themselves. Thus there is nothing in the Act to indicate that "effectiveness of regulation" was sought as an end in and of itself, but rather it was sought as a means of achieving the fundamental objectives of the Act, namely protection of consumers of gas and electricity and protection of investors

in the securities of utility companies. Similarly, economy of management and operation, economy in financial management, and adequacy and efficiency of service, were sought to be achieved by the Act not so much as objectives to be desired in and of themselves but rather to the ultimate end of protecting consumers and investors. The most important of the six factors was the cost of utility service to consumers, since factors such as economy of management and operation, economy in financial management, effectiveness of regulation, and adequacy and efficiency of service, all tend to be reflected in the cost at which electric and gas services are rendered to the consuming public (R. 902).

Counsel for respondent further outlined that Section 11 of the Act seeks to regulate the kind and character of holding companies that may continue to exist by restricting the size and relative geographic location of utilities which one holding company may continue to control. Accordingly, the regulatory devices of Section 11 may be said to involve (1) the character of control over utilities, (2) the size of operating utilities, both as separate integrated systems and as parts of holding company systems, and (3) the relative geographic location of the operating utilities in any holding company system (R. 903).

The specific request for the study is given below in Dr. Waterman's words:

"Stated in a rather general manner, I was asked to make an impartial and objective study to determine whether there is any relationship and, if so, what relationship, between the regulatory devices of Section 11 which I have mentioned and the statutory objectives which I have also mentioned. Stated in more detail, I was asked to make a study to determine whether there are any discernible economic disadvantages which are peculiar to (1) utilities which are controlled by holding companies, (2) utilities and utility holding company systems of large size, and (3) utilities which are related to each other geographically in a manner not permitted by Section 11.

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"Thus, for example, my attention was called to the fact that Section 1 of the Act contains the suggestion, among others, that consumers have been forced to pay more for gas and electric services than otherwise would have been the case because some utility companies have been controlled by holding companies; that some electric and gas rates have been maintained at unnecessarily high levels by reason of excessive service charges and excessive dividends required from subsidiary utility companies by holding companies; that some utility and holding company systems have become so large that they are unwieldy and inefficient with resulting higher rates and less adequate service to consumers and lower returns to investors. I was asked to undertake a study to determine whether these charges are generally true as applied to all holding companies, and whether the suggested economic disadvantages or evils are more generally associated with holding company subsidiaries than with independent utilities. To state it more accurately, I was asked to undertake a study to determine whether there is any evidence that the suggested economic disadvantages or evils are really a function of the fact, or have any real relation to the fact, that a utility is controlled by a holding company, or that a utility or a holding company system reaches a large size, or that utility units in a holding company system are not situated geographically with respect to each other in the manner required by Section 11" (R. 903-4).

Sources of Data

The primary source of data was the rate publications of the Federal Power Commission (FPC) which shows a list of 636 operating utilities constituting all companies which serve in each of 18,000 communities in the United States (which includes all communities of 250 population and over). This source also supplied data regarding size of company and size of community and also the data regarding rates charged for electrical service (R. 910-920).

Utility companies were classified as independent or as holding company subsidiaries in accordance with the Securities and Exchange Commission (SEC) list (R. 917). 182 were independent, 454 were subsidiaries of holding companies. SEC files also yielded information on size of holding company systems and other data *re* holding companies and security issues (R. 918-919).

Moody's Manual was used in checking and interpreting some data taken from these sources and as prime source for certain figures (R. 918-919).

The 636 companies included in the tabulation furnish 95.62% of the total service furnished by private companies in the United States (R. 925).

Method of Statistical Tabulation

As more fully explained above, punch cards (Hollerith) were used and standard machine tabulating methods, handled by experienced personnel. The rate data are built up by use of the average bills in each of the 18,000 communities studied, combined into averages by weighting by the size of the community (R. 920-924).

Determinations

Dr. Waterman's report sets forth at some length the details and character of each of the numerous individual studies comprising said report, and shows as to each such study the precise steps taken and the comparisons made. None of said studies was predicated upon "selected" utilities or "selected" holding company systems. On the contrary, every test or comparison was predicated upon *all* the particular units in question in the United States in respect of which the requisite data were available (R. 917). It is possible in this summary to set forth only the general outline of the various studies and Dr. Waterman's conclusions with respect thereto.

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I. Rates:

Dr. Waterman considered his determinations with respect to rates of service of primary importance because "the impact of all phases of economy in management and operation come to a focus in rates" (R. 960), and because, if holding companies are now guilty of abuses, are too large or unwieldy, or if the distance of operating companies from general headquarters of the holding company has a bad effect, these factors should show in the rates being charged for service (R. 904).

Conclusions:

(a) There is a universal tendency throughout the country for holding company subsidiaries to sell electricity at lower rates than independent utility companies (R. 936, 942-943). This is essentially true no matter how the data are subdivided, whether by communities of various size groups (R. 937, 945-949), by operating companies of various size groups (R. 967, 974), or by geographical districts (R. 940, 950-958).

(b) Size bears a definite relation to level of rates. Rates are lower in larger communities, higher in smaller (R. 937, 945-949). Rates of large utility companies are lower than those of smaller utility companies (R. 974, 1035, 1044-1045).

(c) Rates of subsidiaries of large holding companies are generally lower than those of small holding companies (R. 1079, 1082).

(d) Level of rates of a holding company subsidiary has no statistical relationship to the distance of the operating property from general headquarters of the parent company (R. 1103-1104).*

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* The rate determinations made are with respect to electric rates since Dr. Waterman was unable to find appropriate source data for gas rates (R. 907-908).

II. Costs of Operation:

The second group of studies seeks to determine what relationship exists between economy of operation and the method of control of the operating company, its size and its relative geographic location to the general headquarters of its parent company if it is a subsidiary of a holding company. Conditions under which utilities operate vary widely and operating ratios are defective as measures of efficiency since they are more affected by investment ratios than by efficiency in operation (R. 961). Factors which can properly be compared as between utilities and which, as Dr. Waterman stated, "• • • appeared most likely to have a relation to differences in efficiency as between independent utility operation and holding company subsidiary operation, if any such differences existed" (R. 960), were as follows:

(1) Executive expense or salaries paid to management, per $1,000 of revenue.

(2) Expenses for management and administration, per $1,000 of revenue.

(3) Fees paid for managerial service, per $1,000 of revenue.

Conclusions:

(a) It has already been noted, in I above, that rates are lower for holding company subsidiaries than for independents, thus indicating greater overall efficiency of operation. Executive expense averages nearly three times as high for independent companies as it does for holding company subsidiaries (R. 973). Administrative and general expenses (including management fees) averages 18% higher in independent companies than in holding company subsidiaries. Administrative and general expenses average 20.24% of total operating expenses for independents against 16.02% of total expense for holding company subsidiaries. Management fees average less than 3% of total operating expenses (R. 973). Thus, available evidence as to manage-

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ment and operation indicates that independent utilities are not operated as economically as holding company subsidiaries (R. 972).

(b) Larger companies are operated in some respects more economically than smaller companies and "There is no evidence that increases in the size of operating companies are accompanied by sacrifice in economy of management and operation" (R. 1053-1055). These statements are equally true if independent companies and holding company subsidiaries are segregated and treated as separate groups (R. 1056-1057).

(c) It does not appear that there is any definite relationship between size of the holding company system and economy of management and operation. "There is certainly no evidence that the economy of management of holding company subsidiaries tends to be affected adversely as the size of the holding company system increases; such evidence as there is on the point being to the contrary" (R. 1089-1090).

(d) As to the relative geographic location of operating subsidiaries with respect to general headquarters of the parent company, there is no evidence which "by any stretch of the imagination, could be taken as measuring a significant relationship between such distance factor and the economy and efficiency of the management and operation of the operating company" (R. 1112-1113).

III. Economy in Raising Capital for and Financial Management of Utilities

The factors, considered to be indices of sound financial management, compared in this section are first, the cost of capital (bond money and preferred stock money) and second, the policy of the management in retention of earnings to build up the property as contrasted with the payment of a greater proportion of the earnings in dividends (R. 976). (The second factor is directed particularly toward the

charge in Section 1 of the Act that holding companies paid "excessive dividends" and stripped the operating companies of cash needed for construction.)

Conclusions:

(a) There is no significant difference in the respective costs of bond money to holding company subsidiaries and to independent utilities (R. 985). And "there certainly is no basis for the belief that in recent years independent utilities have enjoyed any advantage over holding company subsidiaries either in the matter of money costs or the costs of raising capital" (R. 987). Data regarding the costs of raising preferred stock capital during the period studied are meager, but such data as there are show no significant differences as between the cost of money to holding company subsidiaries and independents (R. 986-988). "Although the holding company subsidiaries distribute slightly more of their income to bondholders and preferred stockholders than do the independents, in the administration of residual income the holding company subsidiaries appear to be more conservative than the independents" (R. 989, 1001). Thus, holding company subsidiaries retained 45.1% of the common stock earnings, while independent companies retained but 30.8% (R. 1001).

Holding companies supplied over $100,000,000 of common stock equity to over 70 of their operating subsidiaries during the two years 1939 and 1940. During the same period only one independent utility made any significant increase in its residual equity capital (R. 995, 1002-1007). "It rather clearly appears that holding companies provided a source of equity funds for small subsidiaries which was not matched in any way for the small independent utilities" (R. 996). "There are no significant overall differences between independent utilities and holding company subsidiaries on the score of sound and efficient financial management" (R. 996).

(b) The cost of raising bond and preferred stock money decreases as the size of the issuing company increases.

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"* * * large issues of large companies are more acceptable to investors because of greater marketability" (R. 1060-1061). The SEC has issued statistical studies indicating the same conclusion (R. 1059-1060). There is no indication of a direct relationship between size of operating companies and sound and efficient financial management (R. 1064).

(c) Moreover, "there is no real relationship between the size of a holding company system as such and the soundness of the financial management of the operating companies in such system" (R. 1094).

(d) Geographic location of operating subsidiaries with respect to the general headquarters of the parent has no relationship whatever to quality of financial management or the cost of money (R. 1094).

IV. Protection of Investors

These factors were studied by analyzing the usual ratios employed by analysts, namely, interest coverage and percentage of revenues remaining after interest payments.

(a) On the average, independent utilities have a better interest coverage than holding company subsidiaries (R. 1013). However, the averages for independents are greatly affected by a group of issues with exceedingly high coverage which does not carry a corresponding increase in protection to investors (R. 1014). After further analysis, Dr. Waterman concludes that "no investment analyst could properly conclude that the bonds of independent utilities as a whole tend to be better than those of holding company subsidiaries or that holding company subsidiary bondholders as a group tend to be accorded less protection than independent utility bondholders" (R. 1015-1019).

There is no consistent advantage accruing to preferred stockholders of independent utilities as compared with holding company subsidiaries (R. 1025): "if one were to invest in public utility securities at random he would have a better chance of getting a reasonably safe security if he made his choice from securities of holding company sub-

sidiaries than if he made his choice from securities of independent utilities; * * *" (R. 1026). "* * * the fact that utility is controlled by a holding company has no tendency to cause the securities of such utility to be of less desirable character than would be the case if such utility were not so controlled by a holding company, nor does control by a holding company have any tendency to result in less protection to the holders of the security of an operating utility than would otherwise be the case" (R. 1027).

(b) "there is no evidence that mere size of the operating company is a factor which in and of itself is related to either the protection of bondholders or the protection of preferred stockholders of operating utilities. * * * Of course it should be emphasized that this is a statistical conclusion based on averages. The basis forbids that the conclusion be applied to consideration of securities of individual companies since the use of averages brings in a diversity of companies within each size group; * * *" (R. 1071-1072).

(c) " * * * there is no relationship between the size of a holding company system as such and the character or quality of the investment protection afforded to holders of the securities of the operating companies in such system" (R. 1098).

(d) Geographic location of operating property with respect to headquarters of a parent company is not "related in any way to character and quality of protection accorded to the investors in the securities of such operating company" (R. 1121).

V. Effectiveness of Regulation

As already noted "effectiveness of regulation" is not considered to be, in and of itself, an end or purpose of the Act but rather a means to the protection of rate payers and investors (R. 1123). There are no statistical yardsticks available to measure the effectiveness of regulation. Dr. Waterman took the most direct approach by obtaining the opinion of regulatory officials through a questionnaire and

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from a series of interviews with such regulatory officials (R. 1127).

Conclusions:

He found that "there is no evidence that at the present time State regulation of management fees (charged to holding company subsidiaries) is less efficient or effective than State regulation of corresponding charges to independent utilities; certainly there is no reason why it need be less efficient and effective. Moreover, at the present time, so far as operating subsidiaries of registered holding companies are concerned, the regulation of management fees by the S.E.C. is clearly even more comprehensive and effective, by and large, than State regulation of the charges to independent utilities for management services" (R. 1129). The same applies to the quality of management services furnished (R. 1131).

There is no significant difference between holding company subsidiaries and independent utilities so far as cooperation with State regulatory commissions in the regulatory process is concerned (R. 1132). "• • • practically all the State commissions which were interrogated were quite satisfied with their ability to cope equally well with independent utilities and with holding company subsidiaries within the limits of their respective statutory jurisdictions" (R. 1132). "• • • there is no evidence whatever that holding companies and holding company subsidiaries interfere with or impede effective State regulation of financial matters to any greater extent than independent utilities" (R. 1133). State regulation of holding company subsidiaries is at the present time as efficient and effective as state regulation of independent utilities. "It is true that the attitude of some holding company systems with respect to public regulation are not beyond criticism, but the same is equally true of the attitudes of at least a proportionate number of independent utilities" (R. 1135).

If the operating subsidiaries of the respondent should be removed from the regulatory jurisdiction of the SEC by the enforcement of Section 11(b)(1), these subsidiaries "will thereafter in many cases be less effectively and less efficiently regulated than they now are" (R. 1136).